DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNIG GROUP IN 2014

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, February 19th 2015

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Section I: PGNiG Group

The PGNiG Group operates in the energy sector in Poland and abroad. The parent of the PGNiG Group is Polskie Górnictwo Naftowe i Gazownictwo S.A.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with its registered office in Warsaw, ul. Marcina Kasprzaka 25, was established through transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under entry No. RHB 48382. On November 14th 2001, PGNiG S.A. was entered into the Register of Entrepreneurs of the National Court Register under No. KRS 0000059492.

On May 24th 2005, the Polish Securities and Exchange Commission admitted PGNiG shares to public trading. The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the Warsaw Stock Exchange since October 20th 2005. Currently, the share capital of PGNiG S.A. amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share.

The PGNiG Group holds the leading position in most segments of the Polish gas sector, i.e. in oil and gas exploration and production, gas fuel storage, natural gas trading and natural gas distribution. The Group's oil and gas upstream operations, carried out primarily in Poland and on the Norwegian Continental Shelf, provide it with a competitive advantage on the liberalised gas market. The Group's trade and storage operations focus on selling natural gas imported from other countries or produced from domestic fields, and on providing gas supplies at times of peak demand. The distribution operations involve the supply of gas to customers via the distribution network, as well as extending and upgrading of the gas network. In 2012, the PGNiG Group expanded its operations to include electricity and heat generation and sale.

1. Group structure

As at December 31st 2014, the Group comprised PGNiG S.A. (the Parent), and 30 production, trade and service companies, including:

- 21 direct subsidiaries of PGNiG S.A.
- 9 indirect subsidiaries of PGNiG S.A.

The list of the PGNiG Group companies as at December 31st 2014 is presented in the table below.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total voting rights held by PGNiG S.A.
	Direct subsidiaries of PGNiG S.A. – first tier				
1	Exalo Drilling S.A.	981,500,000	981,500,000	100.00%	100.00%
2	GEOFIZYKA Kraków S.A.	64,400,000	64,400,000	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000	66,000,000	100.00%	100.00%
4	PGNiG Upstream International AS (NOK)[1)]	1,092,000,000	1,092,000,000	100.00%	100.00%
5	Polish Oil and Gas Company - Libya B.V. (EUR)[1)]	20,000	20,000	100.00%	100.00%
6	PGNiG Sales & Trading GmbH (EUR)[1)]	10,000,000	10,000,000	100.00%	100.00%
7	Operator Systemu Magazynowania Sp. z o.o.	15,290,000	15,290,000	100.00%	100.00%
8	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550	10,454,206,550	100.00%	100.00%
9	Geovita S.A.	86,139,000	86,139,000	100.00%	100.00%
10	PGNiG Technologie S.A.	182,127,240	182,127,240	100.00%	100.00%
11	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760	51,760	100.00%	100.00%
12	Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation)	1,212,000	1,212,000	100.00%	100.00%
13	PGNiG TERMIKA S.A.	670,324,950	670,324,950	100.00%	100.00%
14	PGNiG Finance AB (SEK) [1)]	500,000	500,000	100.00%	100.00%
15	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100.00%	100.00%
16	PGNiG Obrót Detaliczny Sp. z o.o.	1,091,000,000	1,091,000,000	100.00%	100.00%
17	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100.00%	100.00%
18	PGNiG SPV 6 Sp. z o.o.	250,000	250,000	100.00%	100.00%
19	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100.00%	100.00%
20	B.S. i P.G. Gazoprojekt S.A.[2)]	4,000,000	900,000	22.50%	22.50%
21	NYSAGAZ Sp. z o.o.	9,881,000	6,549,000	66.28%	66.28%
	Indirect subsidiaries of PGNiG S.A. – second tier	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	Ownership interest held by PGNiG S.A.'s subsidiaries	% of total voting rights held by PGNiG S.A.'s subsidiaries
22	Powiśle Park Sp. z o.o.	81,131,000	81,131,000	100.00%	100.00%
23	XOOL GmbH (EUR)[1)]	500,000	500,000	100.00%	100.00%
24	Oil Tech International F.Z.E. (USD)[1)]	20,000	20,000	100.00%	100.00%
25	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	100.00%	100.00%
26	Poltava Services LLC (EUR)[1)]	20,000	19,800	99.00%	99.00%
27	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	85.51%	85.51%
28	GAZ Sp. z o.o.	300,000	240,000	80.00%	80.00%
29	Zakład Separacji Popiołów Siekierki Sp. z o.o.	1,000,000	700,000	70.00%	70.00%
30	Gas Assets Management Sp. z o.o. w organizacji (in the process formation)	20,000	20,000	100.00%	100.00%

[1)] In foreign currencies

[2)] PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members. Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.

Changes in the PGNiG Group's structure in 2014:

- On January 20th 2014, following completion of the liquidation process, PT Geofizyka Torun Indonesia LLC w likwidacji (in liquidation) was deleted from the commercial register; the company was related to GEOFIZYKA Toruń S.A.

- On May 22nd 2014, a new company with a share capital of PLN 1,000,000 was incorporated under the name of Zakład Separacji Popiołów Siekierki Sp. z o.o.; PGNiG TERMIKA S.A. acquired a 70% equity interest, valued at PLN 700,000, in the newly established company; the company was registered with the National Court Register on June 17th 2014; it was established for joint execution (by PGNiG TERMIKA S.A. and Lafarge Cement S.A.) of an investment project consisting in the construction and operation of a fly ash separation system based on a technology allowing recombustion of high-carbon products and use of low-carbon products to produce cement.
- On August 18th 2014, following completion of the liquidation process, Biogazownia Ostrowiec Sp. z o.o. w likwidacji (in liquidation) was deleted from the commercial register; the company was a subsidiary of PGNiG S.A.
- On November 28th 2014, the liquidation of Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation) was completed; by the date of these financial statements, the company had not been deleted from the National Court Register; PGNiG S.A. holds 100% of the company's share capital.
- On December 15th 2014, PGNiG SPV 6 Sp. z o.o. and PGNiG SPV 5 Sp. z o.o. incorporated Gas Assets Management Sp. z o.o. w organizacji (in the process formation), with a share capital of PLN 20,000 divided into 100 shares with a par value of PLN 200 per share; PGNiG SPV 6 Sp. z o.o. and PGNiG SPV 5 Sp. z o.o. acquired equity interests of PLN 19,800 and PLN 200, respectively, in the newly incorporated company; PGNiG S.A. holds a 100% equity interest in the company indirectly through PGNiG SPV 6 Sp. z o.o. and PGNiG SPV 5 Sp. z o.o.; the company was registered with the National Court Register on February 17th 2015.

In 2014, the share capital of PGNiG Obrót Detaliczny Sp. z o.o. was increased by PLN 1,090,000,000, to PLN 1,091,000,000. All the newly issued shares were acquired by PGNiG S.A. and paid for with a non-cash contribution in the form of an organised part of business. The increase was registered with the National Court Register on September 9th 2014.

As at December 31st 2014, the consolidation included PGNiG S.A. (the Parent) and 20 subsidiaries. The chart below presents the consolidated companies of the PGNiG Group as at December 31st 2014 (by segment).

Consolidated PGNiG Group companies

Parent		
Polskie Górnictwo Naftowe i Gazownictwo S.A.		
Segment	**Subsidiaries**	**Ownership interest held by PGNiG S.A.**
Exploration and Production	Exalo Drilling S.A.	100%
	Oil Tech International F.Z.E.	100%
	Poltava Services LLC	99%
	GEOFIZYKA Kraków S.A.	100%
	GEOFIZYKA Toruń S.A.	100%
	PGNiG Upstream International AS	100%
	Polish Oil and Gas Company - Libya B.V.	100%
Trade and Storage	PGNiG Obrót Detaliczny Sp. z o.o.	100%
	PGNiG Sales & Trading GmbH	100%
	XOOL GmbH (EUR)	100%
	Operator Systemu Magazynowania Sp. z o.o.	100%
	PGNiG Finance AB	100%
Distribution	Polska Spółka Gazownictwa Sp. z o.o.	100%
	Powiśle Park Sp. z o.o.	100%
	GAZ Sp. z o.o.	80%
Generation	PGNiG TERMIKA S.A.	100%
Other Activities	Geovita S.A.	100%
	PGNiG Technologie S.A.	100%
	PGNiG Serwis Sp. z o.o.	100%
	B.S. i P.G. Gazoprojekt S.A. *	75%

* PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members.
PGNiG S.A.'s direct interest in the share capital of B.S. i P.G. Gazoprojekt S.A. is 22.50%.
Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.

Changes in management policies

In 2014, the PGNiG Group took steps to reorganise its natural gas trading business, establishing PGNiG Obrót Detaliczny Sp. z o.o., which commenced operations on August 1st 2014. The company took over PGNiG S.A.'s existing gas retail business, while the gas wholesale business remained with the Wholesale Trading Division of PGNiG S.A. The change will enable PGNiG S.A. to meet the requirement, effective as of 2015, to sell 55% of its high-methane gas volumes fed into the transmission network on commodity exchanges.

The PGNiG Group also continued the reorganisation of its underground gas storage segment. In 2014, the Management Board of PGNiG S.A. abandoned its earlier concept for gas storage reorganisation and resolved to incorporate the Wierzchowice Underground Gas Storage Facility Branch in Czarnogoździce into the Zielona Góra Branch. After the reporting period, the Company designated Operator Sytemu Magazynowania Sp. z o.o. to operate, overhaul and maintain the Mogilno

Underground Gas Storage Cavern Facility, and to direct the extraction facility operations, transfer of employees from the Mogilno Underground Gas Storage Cavern Facility Branch in Pałędzie Dolne to OSM Sp. z o.o., and liquidation of the branch. The changes will come into effect in 2015.

2. Ownership interests in other related entities

The list of other related entities of the PGNiG Group as at December 31st 2014 is presented in the table below.

Related entities of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total voting rights held by PGNiG S.A.
	Related entities of PGNiG S.A.				
1	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000	38,400,000	48.00%	48.00%
2	GAS-TRADING S.A.	2,975,000	1,291,350	43.41%	43.41%
3	InterTransGas GmbH w likwidacji (in liquidation) (EUR)[1)]	200,000	100,000.00	50.00%	50.00%
4	Dewon Z.S.A. (UAH)[1)]	11,146,800	4,055,206	36.38%	36.38%
5	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000	73,500	49.00%	49.00%
6	PFK GASKON S.A.	13,061,325	6,000,000	45.94%	45.94%
7	GAZOMONTAŻ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	1,498,850	677,200	45.18%	45.18%
8	ZRUG Sp. z o.o. (Poznań)	3,781,800	1,515,000	40.06%	41.71%
9	ZWUG INTERGAZ Sp. z o.o.	4,700,000	1,800,000	38.30%	38.30%
10	ZRUG TORUŃ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	5,150,000	1,300,000	25.24%	25.24%
	Related entities of PGNiG S.A. subsidiaries	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	Ownership interest held by PGNiG S.A.'s subsidiaries	% of total voting rights held by PGNiG S.A.'s subsidiaries
1	NAFT-STAL Sp. z o.o. w upadłości likwidacyjnej (in bankruptcy by liquidation)	667,500	450,000	67.40%	67.40%
2	Elektrociepłownia Stalowa Wola S.A.	28,200,000	14,100,000	50.00%	50.00%
3	Gazobudowa Kraków Sp. z o.o. w upadłości likwidacyjnej (in bankruptcy by liquidation)	79,500	37,500	47.20%	47.20%
4	Geotermia Sp. z o.o.	4,000	1,000	25.00%	25.00%

[1)] In foreign currencies

Changes in ownership interests within the PGNiG Group in 2014:

- On January 1st 2014, InterTransGas GmbH was placed in liquidation.
- On March 16th 2014, following completion of the liquidation process, Al Mashariq - Geofizyka Torun Limited Company in liquidation was deleted from the commercial register; the company was related to GEOFIZYKA Toruń S.A.
- On April 10th 2014, the District Court for Warszawa-Praga Północ declared GAZOMONTAŻ S.A. insolvent in voluntary arrangement.; by virtue of its decision of November 24th 2014, the court converted the insolvency procedure into bankruptcy by liquidation; PGNiG S.A.'s interest in the share capital of GAZOMONTAŻ S.A. is 45.18%.

- On May 29th 2014, the District Court for Kraków- Śródmieście declared Gazobudowa Kraków Sp. z o.o.'s bankruptcy involving liquidation of the company's assets; PGNiG Technologie S.A. holds a 47.17% interest in the company's share capital.

Equity investments outside the group of related entities

As at the end of 2014, the total par value of the PGNiG Group's equity interests held outside the group of related entities was PLN 33.5m. In 2014, the PGNiG Group made no material equity investments outside the group of related entities.

3. Workforce

The table below presents employment at the PGNiG Group as at December 31st 2014, by segments. Employment at the PGNiG Head Office is presented in the Trade and Storage segment.

Workforce by segment (no. of staff)

	2014	2013
Exploration and Production	10,221	10,754
Trade and Storage	3,929	4,070
Distribution	12,173	13,050
Generation	1,068	1,066
Other Activities	1,605	1,990
Total	28,996	30,930

Compared with December 31st 2013, the number of employees at the PGNiG Group fell by 1,934. The fall in employment came as an effect of measures implemented within the PGNiG Group with a view to improving its cost effectiveness and organisational efficiency. The headcount reduction was strongest in the Distribution segment (down by 877 persons) following the consolidation of six gas distribution companies, implementation of the voluntary termination programme and introduction of additional benefits to encourage eligible employees to opt for retirement. In the Exploration and Production and Other Activities segments, the process of mass redundancies was carried out. Moreover, in 2014 PGNiG S.A. implemented the voluntary termination programme, with 206 employees opting for this solution.

2014 saw a considerable change in the employment structure within the PGNiG Group. As part of the separation of the gas retail from wholesale, on August 1st 2014 2,688 PGNiG S.A. employees were transferred to PGNiG Obrót Detaliczny Sp. z o.o.

On September 24th 2014, PGNiG S.A. terminated the 'Programme for Workforce Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3)', with effect from December 31st 2014. The programme was operated within the PGNiG Group from January 2009 and was to remain in effect until its expiry on December 31st 2015, but its duration could be shortened if terminated by one of the parties. The programme was operated on a stand-by basis. It could be implemented in extraordinary circumstances and required all companies across the Group to follow a uniform procedure. During the programme's effective term (from January 1st 2009 until December 31st 2014) 505 former employees of the PGNiG Group received one-off redundancy payments from PGNiG S.A.'s Central Restructuring Fund capital reserve.

Section II: Parent’s governing bodies

1. Management Board

Pursuant to PGNiG S.A.’s Articles of Association, its Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board. Individual members or the entire Management Board are appointed for a joint three-year term of office.

A member of the Management Board is appointed following a qualification procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 concerning qualification procedures for members of management boards of certain commercial-law companies (Dz. U. No. 55, item 476, as amended). The Regulation does not apply to Management Board members elected by employees.

As long as the State Treasury remains a shareholder of the Company and the Company’s average annual headcount exceeds 500, the Supervisory Board appoints one person elected by the Company’s employees to serve on the Management Board during its term. The Supervisory Board adopts the rules governing election and removal from office of the Management Board member representing the employees, and the rules of by-elections.

Each member of the Management Board may be removed from office or suspended from their duties by the Supervisory Board or the General Meeting.

As at January 1st 2014, the composition of the PGNiG Management Board was as follows:

- Mariusz Zawisza − President
- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production.

On April 3rd 2014, the Supervisory Board of PGNiG S.A. appointed Waldemar Wójcik as member of the Management Board of PGNiG S.A. for a joint three-year term of office ending December 30th 2016. Waldemar Wójcik is a Management Board member elected by the PGNiG S.A. employees in the election held in January and February 2014.

On June 18th 2014, the Supervisory Board of PGNiG S.A. resolved to suspend Mr Andrzej Parafianowicz from his duties as Vice-President of the PGNiG Management Board for Corporate Affairs.

Mr Andrzej Parafianowicz tendered his resignation as Member of the Management Board of PGNiG S.A. on August 7th 2014.

Also on August 7th 2014, the Supervisory Board appointed Mr Waldemar Wójcik as Vice-President of the Management Board of PGNiG S.A.

On December 29th 2014, the Supervisory Board removed Mr Jerzy Kurella from the PGNiG Management Board and from his position as Vice-President for Trade.

As at December 31st 2014, the composition of the PGNiG Management Board was as follows:

- Mariusz Zawisza − President
- Jarosław Bauc – Vice-President, Finance
- Zbigniew Skrzypkiewicz – Vice-President, Exploration & Production
- Waldemar Wójcik – Vice-President.

Until the date of preparation of this report, there were no changes in the composition of the PGNiG Management Board.

Division of responsibilities among the Management Board members

Based on a resolution of the Supervisory Board of PGNiG S.A. on the division of powers among members of the Management Board of PGNiG S.A., dated December 29th 2014:

- The President directs the Management Board's activities and coordinates the work of all its members in all areas of the PGNiG Group's business; the President also supervises and coordinates the Company's operations with respect to delivery of the PGNiG Group's strategic objectives, comprehensive legal services, management of human resources, protection of classified information, defence issues, control and audit, planning and implementation of the Company's trading policies, tariff policies, sales of natural gas, electricity and other products, cooperation with external partners with respect to imports of liquefied natural gas to Poland; moreover, the President's duties include exercise of the owner's supervision within the PGNiG Group and oversight of the operations of the Wholesale Trading Division and of PGNiG S.A.'s foreign representative offices in Moscow and Brussels.

- The Vice-President of the Management Board for Finance supervises and coordinates the Company's operations in the areas of investment policy planning and control and investor relations; moreover, the duties of Vice-President of the Management Board, Finance, include supervision of economic matters, accounting, business controlling, financial management, taxes, planning, and IT systems development and operation at PGNiG S.A.

- The Vice-President of the Management Board for Exploration and Production supervises and coordinates the Company's activities related to its policies, objectives and programmes with respect to hydrocarbon exploration and production in Poland and abroad, procurement strategies within the Company and the Group, safety and operation of the production systems and underground storage facilities, innovation and development projects involving PGNiG S.A.; moreover, the duties of Vice-President of the Management Board, Exploration and Production, include supervision over the operations of the Geology and Hydrocarbon Production Branch, the PGNiG S.A. branches in Odolanów, Sanok and Zielona Góra, the Well Mining Rescue Station in Kraków, the Mogilno Underground Gas Storage Cavern Facility and the Wierzchowice Underground Gas Storage Facility, as well foreign branches.

- The Vice-President of the Management Board elected by employees supervises and coordinates the Company's operations in the areas of administrative management of the Company's property (excluding network assets, extraction assets and underground gas storage facilities), occupational health and safety, cooperation with the transmission, distribution and storage system operators, collaboration with the trade unions, the Employee Council and other employee organisations within the Company and the PGNiG Group; he also supervises the operations of the Central Measurement and Testing Laboratory in Warsaw and of the PGNiG S.A. foreign representative offices in Kiev and Vysokoye.

Contracts with Management Board members

In 2014, the Company executed managerial contracts and non-competition agreements with Mariusz Zawisza, President of the Management Board, and with Vice-Presidents Jarosław Bauc, Jerzy Kurella, Andrzej Parafianowicz, Zbigniew Skrzypkiewicz and Waldemar Wójcik.

2. Supervisory Board

Pursuant to the Articles of Association of PGNiG S.A., the Supervisory Board is composed of five to nine members, appointed by the General Meeting for a three-year joint term of office.

As long as the Polish State Treasury holds an equity interest in the Company, the State Treasury, represented by the minister competent for treasury matters, acting in consultation with the minister competent for economic matters, has the right to appoint and remove one member of the Supervisory Board.

In accordance with the Articles of Association, the General Meeting appoints one independent member of the Supervisory Board. The independent Supervisory Board member is elected in separate voting.

Written nominations of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Meeting by the shareholders present at the General Meeting whose agenda includes the election of such a Supervisory Board member. Any such written proposal should be submitted along with a written representation by a given candidate to the effect that the candidate agrees to stand for the election and meets the criteria for an independent member of the Supervisory Board. If no candidates for the position are proposed by the shareholders, such candidates are nominated by the Supervisory Board.

If the Supervisory Board is composed of up to six members, two members are appointed from among candidates elected by the Company's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among candidates elected by the Company's employees.

As at January 1st 2014, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairperson
- Marcin Moryń – Deputy Chairperson
- Mieczysław Kawecki – Secretary
- Agnieszka Chmielarz – Member
- Józef Głowacki – Member
- Janusz Pilitowski – Member
- Ewa Sibrecht-Ośka – Member
- Jolanta Siergiej – Member.

On March 26th 2014, the Extraordinary General Meeting of PGNiG S.A. appointed Mr Andrzej Janiak as member of the Company's Supervisory Board. Mr Andrzej Janiak meets the independence criteria defined in the Company's Articles of Association.

In connection with the expiry of the Supervisory Board's term of office, on May 15th 2014 the Annual General Meeting of PGNiG S.A. removed all members of the Supervisory Board and appointed, for a joint three-year term of office commenced on May 15th 2014, the Supervisory Board composed of: Wojciech Chmielewski, Sławomir Borowiec, Andrzej Janiak (independent member), Bogusław Nadolnik, Janusz Pilitowski, Agnieszka Trzaskalska, Ryszard Wąsowicz, Agnieszka Woś and Magdalena Zegarska.

Janusz Pilitowski represents the State Treasury and was appointed in consultation with the Minister of Economy. Sławomir Borowiec, Ryszard Wąsowicz and Magdalena Zegarska are Supervisory Board members elected by the PGNiG S.A. employees in the election held in January and February 2014.

On May 20th 2014, at its first meeting, the Supervisory Board constituted itself with Wojciech Chmielewski as Chairperson, Agnieszka Woś as Deputy Chairperson and Magdalena Zegarska as Secretary.

On July 30th 2014, Agnieszka Trzaskalska tendered her resignation as Member of the Supervisory Board of PGNiG S.A.

On November 6th 2014, Bogusław Nadolnik tendered his resignation as Member of the Supervisory Board of PGNiG S.A.

As at December 31st 2014, the Supervisory Board of PGNiG S.A. was composed of seven persons, including:

- Wojciech Chmielewski – Chairperson
- Agnieszka Woś – Deputy Chairperson
- Magdalena Zegarska – Secretary
- Sławomir Borowiec – Member
- Andrzej Janiak – Member
- Janusz Pilitowski – Member
- Ryszard Wąsowicz – Member.

Until the date of preparation of this report, there were no changes in the composition of the PGNiG Supervisory Board.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the full-year consolidated financial statements for the year ended December 31st 2014 (Note 36.5).

Section III: Shareholding structure

As at December 31st 2013, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series A, A1 and B, were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The shareholding structure of PGNiG S.A. as at December 31st 2014 is presented in the table below.

Shareholding structure

Shareholder	Number of shares as at Dec 31 2014	Percentage of share capital held as at Dec 31 2014	Number of voting rights conferred by shares held	Percentage of total voting rights at GM as at Dec 31 2014
State Treasury	4,271,717,836	72.4%	4,271,717,836	72.4%
Open-end pension funds	651,437,632	11.0%	651,437,632	11.0%
Other shareholders	976,844,532	16.6%	976,844,532	16.6%
Total	5,900,000,000	100.0%	5,900,000,000	100.0%

<u>PGNiG shares and shares in PGNiG S.A.’s related entities held by management and supervisory personnel</u>

The table below presents the management and supervisory personnel’s holdings of PGNiG shares as at December 31st 2014.

PGNiG shares held by the management and supervisory personnel

Name	Position	Number of shares	Par value of shares (PLN)
Waldemar Wójcik	Member of the Management Board	19,500	19,500
Ryszard Wąsowicz	Member of the Supervisory Board	19,500	19,500

<u>Agreements which may give rise to future changes in the interests held by the existing shareholders or bondholders</u>

As at the date of this report, PGNiG S.A. was not aware of any agreements which could lead to future changes in the equity interests held in the Company by its existing shareholders.

<u>Performance of the PGNiG stock</u>

PGNiG shares have been listed at the Warsaw Stock Exchange since September 23rd 2005. As at December 31st 2014, the Company was included in the following indices listed at the WSE:

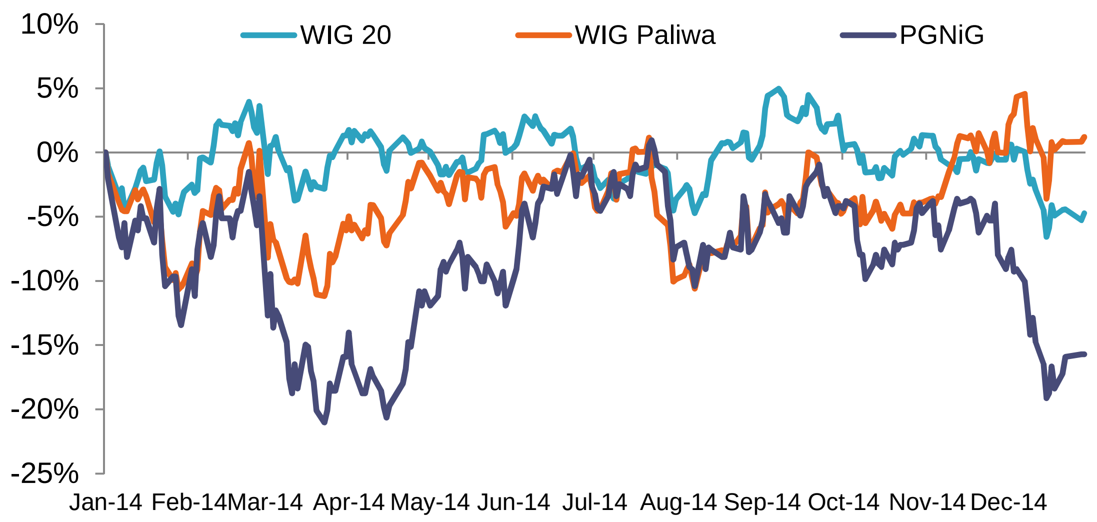
- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies
- WIG-Paliwa – index of the fuel sector companies
- WIG-div – total return index (taking into account dividends and pre-emptive rights)

- WIG-Poland – index of Polish companies
- Respect Index – index of socially responsible companies.

The rate of return on the PGNiG stock in 2014 was -13.6%. Investors who acquired PGNiG shares at their issue price achieved a cumulative rate of return of 47% (excluding dividends).

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG-Paliwa indices. The table presents the values of the WSE indices and the PGNiG share price in 2014.

PGNiG share price vs. the WIG 20 and WIG Paliwa indices



Performance of WSE indices and PGNiG stock

Index	Value/price as at Dec 30 2013	2014 high	2014 low	Value/price as at Dec 30 2014	PGNiG's weight in the index as at Jan 8 2015
WIG (points)	51,284	55,637	49,521	51,416	2.52%
WIG20 (points)	2,401	2,551	2,271	2,316	3.80%
WIG-Paliwa (points)	3,215	3,493	2,967	3,381	28.50%
Respect Index (points)	2,559	2,933	2,450	2,674	7.34%
PGNiG S.A. (PLN)	5.15	5.33	4.17	4.45	-

Source: gpwinfostrefa.pl.

Section IV: PGNiG Group's development directions

On December 29th 2014, the Supervisory Board of PGNiG S.A. approved the PGNiG Group's Strategy for 2014–2022.
The Strategy covers four business areas and ten strategic initiatives, which should allow the Group to earn EBITDA of approximately PLN 7bn in 2022, keep the net debt to EBITDA ratio below 2, and pay out dividends at 50% of the consolidated net profit (with a proviso that in its dividend recommendations, the PGNiG Management Board will always take into account the current financial standing of the PGNiG Group and its investment plans). In the period covered by the Strategy, capital expenditure on organic growth and acquisitions is expected to reach PLN 40bn-50bn. An important factor for delivery of the strategic objectives will be the expected increase in hydrocarbon production to approximately 50-55 mboe in 2022, with the annual production in Poland maintained at the current level of approximately 33 mboe.

The business areas covered by the PGNiG Group's Strategy for 2014-2022 include:

- Maintaining stable trading volumes (both in retail and wholesale)
- Maximising cash flows from the infrastructure and generation area
- Strengthening and transforming the exploration and production area
- Laying foundations for growth along the value chain

As regards the objective of maintaining stable trading volumes (both in retail and wholesale), the PGNiG Group will seek to maintain its leading position on the gas market and to remain the preferred gas supplier for all customer segments. The Group intends to achieve these objectives by developing and implementing mechanisms to improve customer service quality and encourage customers to continue their business relationships with the Group. The PGNiG Group also intends to maintain the high stability of gas supplies to end customers and to enhance its product offering through such initiatives as launch of *dual fuel* products. The priority in this area is to develop and implement mechanisms that would mitigate the risk related to the Company's long-term gas import contracts. The PGNiG Group will also seek to introduce more flexibility into its natural gas portfolio and adjust the portfolio to the changing pricing and supply/trading conditions on the market, while maintaining its ability to ensure energy security.

The PGNiG Group's grid infrastructure, gas storage, and electricity and heat generation assets are a source of predictable, stable revenue and deliver attractive rates of return relative to the risks. In the coming years, the assets will prove important in stabilising the Group's financial performance and enhancing its ability to finance new projects. In a highly competitive environment, it will be of key importance to maximise cash flows from this business area and to allocate any free cash to growth-oriented projects that will fully exploit the Group's potential and synergies available in new growth areas. The Group will pursue new, profitable transmission infrastructure projects (heat networks) as one of its development directions.

The Exploration and Production segment will continue to play a major role in the development of the PGNiG Group. The Group's main objective is to maintain stable production of natural gas and crude oil in Poland. In addition, to secure further meaningful growth of shareholder value, the Group intends to take active steps to build a portfolio of foreign exploration and production assets. The PGNiG Group will continue the exploration and appraisal of *shale gas* deposits in Poland within its most prospective licence areas, with a view to verifying recoverable unconventional reserves of hydrocarbons and commencing their economically-viable production in the shortest possible time.

To ensure further growth at each stage of its value chain, the PGNiG Group will take steps to improve its cost effectiveness and organisational efficiency. These measures will include cost rationalisation, development of new business areas, and focus on the Group's principal business activity. Their implementation will improve the Group's ability to finance new projects and enhance its competitive position.

Section V: Operating review of the PGNiG Group

1. Operating data

Financial performance of the PGNiG Group in 2011−2014

	Unit of measure	2014	2013	2012	2011
Revenue	PLNm	34,304	32,044	28,730	23,004
Operating expenses, including:	PLNm	-30,461	-28,895	-26,190	-21,132
depreciation and amortisation	PLNm	-2,502	-2,463	-2,069	-1,574
EBIT (operating profit)	PLNm	3,843	3,149	2,540	1,872
EBITDA (operating profit + depreciation/amortisation)	PLNm	6,345	5,612	4,609	3,446
Net profit/(loss)	PLNm	2,822	1,920	2,240	1,755
Number of shares	million shares	5,900	5,900	5,900	5,900
Earnings per share (net profit/number of shares)	PLN	0.48	0.33	0.38	0.3
Declared or paid dividend per share (dividend paid/number of shares)	PLN	0.15	0.13	-	0.12

* average share price in a given year

In 2014, the PGNiG Group reported revenue of PLN 34.3bn, 79% of which was derived from sales of natural gas.

Revenue (PLNm)

	2014	2013	2012	2011
Natural gas, including:	27,128	24,970	23,698	20,269
- high-methane gas	25,726	23,540	22,309	19,052
- nitrogen-rich gas	1,402	1,430	1,389	1,217
Crude oil	2,654	2,757	1,263	1,100
Helium	120	183	161	58
Electricity	1,695	1,360	842	11
Heat	1,079	1,069	978	0
Geophysical and geological services	281	239	339	448
Drilling and well services	480	594	610	578
Construction and assembly services	135	243	123	132
Connection charge	112	110	106	97
Other sales	620	519	610	311
Total	34,304	32,044	28,730	23,004

In 2014, the PGNiG Group sold 18.6 bcm of natural gas, with 96% of that amount representing sales from the transmission and distribution systems and the balance – direct sales from gas fields.

Natural gas sales volume (mcm)

	2014	2013	2012	2011
Trade and Storage	17,808	15,465	14,189	13,595
Exploration and Production	801	749	723	682
Total	18,609	16,214	14,912	14,277

The PGNiG Group produced a total of 4.5 bcm of natural gas (measured as high-methane gas equivalent), of which 89% was produced from fields in Poland, and the balance – from fields on the Norwegian Continental Shelf and in Pakistan.

Natural gas production volume (mcm)

	2014	2013	2012	2011
Poland	4,027	4,211	4,317	4,329
Abroad	477	371	0	0
Total	4,504	4,582	4,317	4,329

In 2014, 100% of the electricity produced by the Group's Generation segment was electricity co-generated with heat.

Electricity and heat production volumes

	Unit of measure	2014	2013	2012	2011
Electricity	GWh	4,173	4,436	4,390	
Heat	TJ	36,923	40,540	40,568	

2. Events in 2014

January	PGNiG Upstream International AS acquired a 50% interest in the PL756 licence on the Norwegian Continental Shelf and was awarded its operatorship. Given the political unrest in Libya posing a threat to its employees, POGC Libya B.V. suspended exploration within its Libyan licence.
February	PGNiG Upstream International AS and its partners relinquished the PL600 licence on the Norwegian Continental Shelf.
March	The Extraordinary General Meeting of PGNiG S.A. appointed Mr Andrzej Janiak as member of the Company's Supervisory Board.
April	The Supervisory Board of PGNiG S.A. appointed Waldemar Wójcik as member of the Management Board of PGNiG S.A. for a joint three-year term of office ending December 30th 2016.
May	PGNiG Upstream International AS and its partners relinquished the PL599 licence on the Norwegian Continental Shelf. The Annual General Meeting of PGNiG S.A. removed all members of the Supervisory Board and appointed, for a joint three-year term of office commenced on May 15th 2014, the Supervisory Board composed of: Wojciech Chmielewski, Sławomir Borowiec, Andrzej Janiak, Bogusław Nadolnik, Janusz Pilitowski, Agnieszka Trzaskalska, Ryszard Wąsowicz, Agnieszka Woś and Magdalena Zegarska. Operator Systemu Magazynowania Sp. z o.o. began to offer the expanded working capacities of the Wierzchowice Underground Gas Storage Facility and the Strachocina Underground Gas Storage Facility.
June	On June 13th 2014, the President of the Energy Regulatory Office approved a change to PGNiG Gas Fuel Supply Tariff No. 6/2014 and extended its effective term until December 31st 2014. The gas fuel prices were restated from amounts based on m^3 to amounts based on kWh. The Supervisory Board of PGNiG S.A. resolved to suspend Mr Andrzej Parafianowicz from his duties as Vice-President of the PGNiG Management Board for Corporate Affairs.
July	Operator Systemu Magazynowania Sp. z o.o. began to offer the working capacities of the new Kosakowo Underground Gas Storage Cavern Facility. Ms Agnieszka Trzaskalska resigned as member of the Supervisory Board of PGNiG S.A.

August	PGNiG Obrót Detaliczny Sp. z o.o. commenced its operations. It took over the existing gas retail business of PGNiG S.A. Mr Andrzej Parafianowicz, Vice-President of the Management Board for Corporate Affairs, tendered his resignation as member of the PGNiG Management Board.
September	PGNiG Upstream International AS acquired interests in four fields located on the Norwegian Continental Shelf from Total E&P Norge AS. The interests cover six licences on the following fields: Morvin, Vilje, Vale and Gina Krog. As a result of the transaction, PGNiG Upstream International AS' recoverable reserves in Norway grew by ca. 60%.
November	Mr Bogusław Nadolnik tendered his resignation as member of the PGNiG Supervisory Board.
December	PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) executed a supplementary agreement to the contract for sale of liquefied natural gas (LNG) of June 29th 2009. The agreement will minimise the risk of PGNiG S.A. having to pay for uncollected LNG under the take or pay clause. The President of the Energy Regulatory Office approved PGNiG Gas Fuel Supply Tariff No. 7/2015 (wholesale tariff), effective from January 1st 2015 to April 30th 2015. The average price of high-methane and nitrogen-rich (Lw) gas was reduced by ca. 4% and 1.4%, respectively. The President of the Energy Regulatory Office approved PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1, effective from January 1st 2015 to December 31st 2015. The average trading price of gas fuel was reduced by 1.8% for high-methane gas (E), 0.8% for nitrogen-rich gas (Lw), 1.1% for nitrogen-rich gas (Ls), and 1.6% for decompressed propane-butane. The Supervisory Board of PGNiG S.A. removed Mr Jerzy Kurella from the PGNiG Management Board and from his position as Vice-President for Trade. PGNiG S.A. completed the extension of the Husów Underground Gas Storage Facility.

Section VI: Regulatory environment

The PGNiG Group's activities are regulated by the following laws:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of 2012, item 1059) with secondary legislation, to the extent it governs gas fuel trading, distribution and storage, as well as foreign trade in natural gas.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007 (consolidated text in Dz. U. of 2012, item 1190) with secondary legislation, to the extent it governs gas fuel storage and foreign trade in natural gas.
- Polish Geological and Mining Law of June 9th 2011 (Dz. U. of 2011, No. 163, item 981, as amended), to the extent it governs production and sale of gas.

On July 25th 2014, a new Act on Special Hydrocarbon Tax was passed by the Sejm (lower house of the Polish Parliament). The Act introduces a special hydrocarbon tax to the Polish tax regime and adds oil and gas to the list of items subject to tax on production of certain minerals. The Act sets the rates of the new taxes at:

- special hydrocarbon tax – 0-25% of profit from upstream operations, depending on the ratio of revenue to eligible expenditure incurred by the company;
- tax on production of certain minerals – 3% (in the case of gas produced from conventional deposits), 1% (in the case of gas produced from unconventional deposits), 6% (in the case of oil produced from conventional deposits), and 3% (in the case of oil produced from unconventional deposits).

The Act will come into force on January 1st 2016. The obligation to pay the special hydrocarbon tax will apply to revenue earned as of January 1st 2020, and the obligation to pay the tax on production of certain minerals, in the case of oil and gas, will arise as of January 1st 2020

1. Polish Energy Law

The activities of the PGNiG Group companies in the area of gas fuel trading, distribution and storage, electricity trading and generation, as well as heat generation, transmission and distribution are quite heavily regulated, and require a licence granted by the President of the Energy Regulatory Office.

The amended Polish Energy Law of 2013 introduced the requirement to sell a specific portion of high-methane gas volumes fed into the transmission network in a given year on commodity exchanges. In 2014, the requirement covered 40% of total volumes. Given insufficient demand for gas offered by PGNiG S.A. on the exchange market, it was necessary to amend the Law so as to eliminate the structural obstacles to meeting the exchange sale requirement. On June 26th 2014, a new Act Amending the Energy Law was passed, introducing the so called general succession of agreements. Following the Act's entry into force, on August 1st 2014 PGNiG Obrót Detaliczny Sp. z o.o. commenced its operations, taking over a part of PGNiG S.A.'s portfolio of retail customers (who in 2013, under agreements with PGNiG S.A., received no more than 25 mcm of gas fuel from the transmission or distribution network at all points).

On April 30th 2014, a new Act Amending the Energy Law and Certain Other Acts came into force. The Act reinstated the mechanism of support for electricity produced by co-generation for 2014-2018. Under the Act, energy utilities selling electricity to end users are obliged to purchase and redeem a certain number of certificates of origin for electricity produced by co-generation. The reinstated mechanism, which supports gas-fired co-generation, creates an opportunity for PGNiG S.A. to increase the volume of gas sold in this segment. In addition, the possibility of generating additional revenue from sale of certificates of origin will have a positive effect on the financial performance of PGNiG TERMIKA S.A.

1.1. Licences

As at December 31st 2014, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office (URE) under the Energy Law:

- one licence to trade in gas fuels
- one licence to trade in natural gas with foreign partners
- one licence to trade in liquid fuels
- one licence to produce electricity
- one licence to trade in electricity.

PGNiG Obrót Detaliczny Sp. z o.o. held a licence to trade in gas fuels valid from April 25th 2014 to April 25th 2016 and a licence to trade in electricity valid from April 29th 2014 to April 29th 2016. On October 23rd 2014, PGNiG Obrót Detaliczny Sp. z o.o. requested the President of the Energy Regulatory Office to extend the term of the licences. As at the date of this report, the proceedings were still pending.

1.2. Changes in gas fuel tariffs

In 2014, the bulk of high-methane and nitrogen-rich natural gas sold by PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. was subject to statutory price control. Only trade in high-methane natural gas on the Polish Power Exchange was exempt from the obligation to submit tariffs for approval.

In 2014, PGNiG Gas Fuel Supply Tariff No. 6/2014, approved by decision of the President of the Energy Regulatory Office dated December 17th 2013, was in effect.

On June 13th 2014, the President of the Energy Regulatory Office approved a change to PGNiG Gas Fuel Supply Tariff No. 6/2014 and extended its effective term until December 31st 2014. The amendment was designed to harmonise the tariff with the Minister of Economy's Regulation dated June 28th 2013, under which, starting from August 1st 2014, settlements with customers would be based on energy units, while earlier they had been based on units of volume. The new settlement rules did not significantly affect the amounts of payments for gas fuel supplies. The prices of gas fuels were recalculated from amounts expressed per cubic metre into amounts expressed per 1 kWh, with use of the calorific value assumed to determine prices per unit of volume. Changes in payments, if any, may result from differences between calorific values at different places of the gas network or rounding recalculation results (which should not exceed +/-1%).

The following tables present the average rates (gas fuel prices, subscription fees and network charges) applicable in 2014 in settlements with customers purchasing gas fuels, by fuel type and place of delivery (PLN/cubic metre), and the change in their amounts relative to the previous tariff. The amounts do not include excise duty introduced on November 1st 2013.

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Wrocław Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.4969	2.6150	4.7%
W-2.1	1.9816	2.0512	3.5%
W-3.1	1.8029	1.9005	5.4%
W-4	1.6693	1.7912	7.3%
W-5 - W-7C	1.7071	1.7001	-0.4%

W-8A - W-10C	1.4651	1.4653	0.0%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
S-1	1.7900	1.8950	5.9%
S-2	1.4044	1.5152	7.9%
S-3	1.3013	1.4098	8.3%
S-4	1.1801	1.3035	10.5%
S-5 - S-7B	1.2338	1.2468	1.1%
S-8 - S-9	1.1225	1.1394	1.5%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
Z-1	1.4156	1.5102	6.7%
Z-2	1.2888	1.3774	6.9%
Z-3	1.1623	1.2508	7.6%
Z-4	1.0841	1.1759	8.5%
Z-5 - Z-7B	1.1793	1.1772	-0.2%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Zabrze Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.4726	2.6051	5.4%
W-2.1	2.0440	2.1095	3.2%
W-3.1	1.7660	1.8807	6.5%
W-4	1.6909	1.8102	7.1%
W-5 - W-7C	1.7314	1.7379	0.4%
W-8A - W-11C	1.4681	1.4696	0.1%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Tarnów Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.3594	2.4663	4.5%
W-2.1	1.9590	2.0228	3.3%
W-3.1	1.7288	1.8246	5.5%
W-4	1.6843	1.7779	5.6%
W-5 - W-7BC	1.7355	1.7524	1.0%
W-8A - W-10C	1.4310	1.4423	0.8%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Warsaw Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.7039	2.7874	3.1%
W-2.1	1.8693	1.9397	3.8%
W-3.1	1.6877	1.7924	6.2%
W-4	1.6755	1.7673	5.5%
W-5 - W-7C	1.7086	1.7275	1.1%
W-8A - W-10C	1.3669	1.3700	0.2%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Gdańsk Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.5658	2.6739	4.2%
W-2.1	2.0058	2.0806	3.7%
W-3.1	1.8006	1.9066	5.9%
W-4	1.7451	1.8457	5.8%
W-5 - W-7C	1.7606	1.7742	0.8%
W-8A - W-10C	1.4601	1.4500	-0.7%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Poznań Branch

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
W-1.1	2.5856	2.6962	4.3%
W-2.1	1.9143	1.9939	4.2%
W-3.1	1.7881	1.8870	5.5%
W-4	1.7032	1.8098	6.3%
W-5 - W-7C	1.6715	1.6640	-0.5%
W-8A - W-10C	1.4140	1.4110	-0.2%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
S-1	1.8046	1.9231	6.6%
S-2	1.3774	1.5069	9.4%
S-3	1.2602	1.3967	10.8%
S-4	1.1889	1.3290	11.8%
S-5 - S-7B	1.2365	1.2772	3.3%

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
Z-1	1.6422	1.7424	6.1%
Z-2	1.2408	1.3500	8.8%
Z-3	1.1208	1.2362	10.3%
Z-4	1.0570	1.1753	11.2%
Z-5 - Z-7B	1.1157	1.1464	2.8%

Customers connected to the transmission grid of OGP GAZ-SYSTEM S.A.

	Amendment to Tariff No. 5/2012	Tariff No. 6/2014	Change (%)
	1	2	2/1
E-1A - E-2C	1.3302	1.3141	-1.2%
Lw-1 - Lw-2	1.0196	1.0283	0.8%
Ls-1 - Ls-2	0.8537	0.8794	3.0%

Pursuant to the Energy Law, PGNiG Obrót Detaliczny Sp. z o.o. was authorised to use PGNiG Gas Fuel Supply Tariff No. 6/2014 until the introduction of a new tariff, prepared by PGNiG Obrót Detaliczny Sp. z o.o. In October 2014, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. applied to the President of the Energy Regulatory Office for approval of the new tariff.

On December 17th 2014, the President of the Energy Regulatory Office approved PGNiG Gas Fuel Supply Tariff No. 7/2015, applicable from January 1st 2014 to April 30th 2015. The tariff provided for a new, more flexible classification of natural gas customers into tariff groups (e.g. depending on contracted gas volumes, connection points and unbalanced consumption rates). The average price (the price of gas fuel and the subscription fee) of high-methane and nitrogen-rich (Lw) gas was reduced by ca. 4% and 1.4%, respectively. The PGNiG Tariff is applicable to businesses purchasing fuels for resale and end users with annual gas consumption exceeding 25 mcm.

On December 17th 2014, the President of the Energy Regulatory Office approved PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1, effective from January 1st 2015 to December 31st 2015. The average trading price of gas fuel (gas fuel price and subscription fee) was reduced relative to the previous tariff by 1.8% for high-methane gas (E), 0.8% for nitrogen-rich gas (Lw), 1.1% for nitrogen-rich gas (Ls), and 1.6% for decompressed propane-butane. On October 27th 2014, the President of the Energy Regulatory Office exempted PGNiG Obrót Detaliczny Sp. z o.o. from the obligation to submit LNG trading tariffs for approval.

The complete PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 1 is available at www.od.pgnig.pl and www.ure.gov.pl.

Exemption from the obligation to submit wholesale gas trading tariffs for approval

On February 19th 2013, the President of the Energy Regulatory Office announced an exemption of energy utilities holding gas fuel trading licences from the obligation to submit wholesale gas trading tariffs for approval. However, energy utilities must individually apply to the President of the Energy Regulatory Office for the exemption. PGNiG S.A. submitted such application to the President of the Energy Regulatory Office, and, as at the date of this report, the proceedings were still pending.

Furthermore, in 2013 PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit for approval tariffs for high-methane natural gas (E) traded at a virtual gas trading point (*OTC* market). As at the date of this 2014 report, the proceedings were still pending.

2. Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

The Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market regulates matters related to ensuring the national fuel security, and sets the rules for building up, maintaining, and financing stocks of natural gas by those energy companies whose business involves international trade in natural gas or which import gas for their own needs. With respect to the business activity of PGNiG S.A., the Act:

- specifies the volume of mandatory stocks, which since October 1st 2012 is equivalent to 30 days' average daily imports of gas (for the period from April 1st of the previous year to March 31st of the current year, calculated based on the figures contained in the Company's statistical reports);
- provides that the return on capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the mandatory stocks represents a justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law;
- introduces the possibility of storing mandatory stocks in another EFTA or EU member state, upon fulfilment of certain conditions set forth in the Act;
- introduces the possibility of exempting an energy company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to build and maintain mandatory stocks, if the number of their customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100 mcm.

3. Polish Geological and Mining Law

The Polish Geological and Mining Law of June 9th 2011 regulates:

- geological work;
- extraction of minerals from deposits;
- storage of waste matter in rock mass, including in worked-out caverns;
- protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Furthermore, under the Act, a tender procedure was introduced to award licences for exploration or appraisal of hydrocarbons and for production of hydrocarbons, superseding the previous tender procedure for establishment of mineral extraction rights. The provisions of the Geological and Mining Law also govern business activities in the area of tankless storage of substances in rock mass, including in worked-out caverns.

Business activities involving exploration for and appraisal of mineral deposits, extraction of minerals from deposits, tankless storage of substances and storage of waste matter in rock mass, including in worked-out caverns, require licences.

Geological and mining activities are subject to supervision by competent geological and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions for a failure to comply with its regulations, and specifies the upper and lower limits of royalty fees.

On July 11th 2014, a new Act Amending the Geological and Mining Law was passed, introducing a number of material changes to the regulatory environment of the exploration and production segment. The Act has introduced an integrated permit (covering hydrocarbon exploration, appraisal and production) and obligatory qualification procedures, allowed consortia to apply for licences and significantly increased royalty rates (while maintaining the previous royalty regime for marginal deposits).

In 2014, the Ministry of Environment granted PGNiG S.A. eight licences for exploration and appraisal of crude oil and natural gas deposits, while one licence was not extended. In addition, the Company relinquished 14 licences prior to their expiration. The Company was also granted six licences for production of crude oil and natural gas, while six other licences were allowed to expire.

As at December 31st 2014, PGNiG S.A. held the following licences, granted pursuant to the Geological and Mining Law:

- 77 licences for exploration and appraisal of crude oil and natural gas deposits

- 227 licences for production of crude oil and natural gas from deposits
- 9 licences for storage of gas in underground facilities (underground gas storage facilities)
- 3 licences for storage of waste.

4. Regulatory risks

Polish Energy Law

The Act Amending the Energy Law and Certain Other Acts (the so-called "Small Three Pack") of September 11th 2013 has introduced a requirement to sell gas on the exchange market. The requirement to sell gas on the exchange market, which now applies to the Company, is aimed to deregulate the Polish gas market and boost competition. The mechanism improves the market's transparency and allows market participants to purchase products on equal terms. On the other hand, it may cause PGNiG to gradually lose its market share. However, the actual rate at which PGNiG S.A.'s market share might shrink will depend on the number and size of new players entering the gas market and the price differentials between the PGNiG tariff price and prices quoted by other market participants.

Meeting the requirement to sell gas on the exchange market

In terms of supply, PGNiG S.A. is fully prepared to meet its statutory obligation to sell gas through the exchange market. In 2014, the Company was required to sell 40% of its total sales volume through the exchange market. Starting from January 1st 2015, this requirement will cover 55% of the total gas sold. If an energy utility fails to meet the requirement to sell gas through the exchange market, the President of the Energy Regulatory Office may impose on it a fine of up to 15% of its full-year revenue generated from the licensed activity in the previous fiscal year. Given the insufficient demand for gas on the exchange market before the effective date of the Act Amending the Energy Law of June 26th 2014 (which introduced the general succession of agreements), the Company was unable to meet its statutory exchange sale obligation in 2014. In order to ensure the meeting of this requirement, a new company, PGNiG Obrót Detaliczny Sp. z o.o., commenced its operations in August 2014, consisting in buying natural gas at the Polish Power Exchange, and then selling it to retail customers. Since the effective date of the Act introducing the general succession of agreements, the volume of gas sold through the exchange has increased substantially. This will allow the Company to meet its statutory obligation in the coming years. However, the President of the Energy Regulatory Office may impose fines on the Company for failing to meet this obligation in 2013 and 2014.

Tariff calculation

Dependence of the PGNiG Group's revenue on tariffs approved by the President of the Energy Regulatory Office is the key factor affecting the Group's regulated business. Tariffs are crucial to the Company's ability to generate revenue that would cover its reasonable costs and deliver a return on the capital employed. Currently, a significant portion of that revenue depends on the selling prices of gas fuel, which − except to the extent that the gas is sold through the Polish Power Exchange − are regulated prices. The tariff determination rules are defined in the regulations issued under the Energy Law, including primarily the Tariff Regulation. The tariff determination methodology is based on planned volumes. Inaccurate estimates of customer demand for gas (affecting the accuracy of projected purchase and supply volumes), changes in imported gas prices which cannot be accurately projected, as well as unpredictable fluctuations in currency exchange rates (ultimately affecting the cost of gas imports) may have an adverse effect on the financial performance of the Group.

Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

Meeting the statutory requirements related to mandatory stocks exposes PGNiG S.A. to balancing and technology risks, and threatens the performance of its contractual obligations.

The balancing risk is related to the Company’s inability to meet peak demand for natural gas in autumn and winter months. During longer spells of low temperatures, it may happen that – despite maximum gas supplies under long-term contracts and from underground gas storage facilities (remaining at the disposal of PGNiG S.A.) – the demand for gas will exceed the volumes which the Company is able provide. This risk may arise even assuming the maximum use of import capacities. To note, given the legally required technical parameters necessary to deliver mandatory gas stocks to the system, a significant portion of the stocks had to be placed at the Mogilno underground gas storage cavern, which is a peak-demand storage facility. As a result, the mandatory stocks significantly limit the commercial use of the facility’s storage capacity and deliverability. As gas from mandatory stocks may be withdrawn only upon the Minister of Economy’s consent and only after gas supply limits have been introduced for users, the Company may fail to ensure continuity of gas supplies to consumers. Notwithstanding the above, withdrawal of gas from stocks may lead to a situation where users face gas supply limits despite high volumes of gas held in storage.

The technology risk follows from the fact that the need to maintain mandatory stocks has a negative impact on the operating parameters of underground storage facilities. In a longer run, if gas is not drawn from water-drive storage facilities (such as the Husów Underground Gas Storage Facility), gas will migrate to the reservoir section with poorer porosity and permeability, which will lead to a decrease in gas withdrawal capacity. This could make gas withdrawal more difficult at the end of the withdrawal process, and will reduce withdrawal capacity in the next cycle. In order to restore the operating parameters of the facility, it may be necessary to inject more gas to increase buffer volumes, which will in turn entail additional costs.

Another consequence of maintaining mandatory stocks is that the storage capacities remain partially filled after the winter season is over, which reduces the injection capacities in the summer. Mandatory stocks for the 2014/2015 season remain high. Consequently, PGNiG may not be able to meet its contractual obligation concerning the summer minimum offtake under the Yamal contract because of high volumes of gas in storage at the beginning of summer, attributable to mandatory stocks.

Geological and Mining Law

In July 2014, legislative work was completed on a fundamental change in the regulatory regime for the exploration and production segment, comprising two bills: the draft Act Amending the Geological and Mining Law and Certain Other Acts, and the draft Act on the Special Hydrocarbon Tax. They provide for increasing the fiscal burden on production of minerals and for a change to the existing licensing system. The introduction of the special hydrocarbon tax as of 2020 will considerably impair PGNiG S.A.’s capabilities to make new investments, while the new licensing system (under which the open door procedure will not apply) may significantly slow down the administrative processes, ultimately leading to a decline in the number of hydrocarbon exploration and appraisal licences issued in Poland.

Section VII: Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, from geological analyses, to geophysical surveys and drilling work, to field development and hydrocarbon production. The work is conducted by the segment on its own or jointly with partners, under joint operations agreements. It relies on storage capacities available at the Daszewo and Bonikowo Underground Gas Storage Facilities.

The PGNiG Group is the leader of the Polish hydrocarbon exploration and production market. As of 1990, hydrocarbon exploration in Poland is based on a licensing policy which ensures equal access to exploration licences for all market participants. As at December 31st 2014, PGNiG S.A. held 77 crude oil and natural gas exploration and appraisal licences (compared with approximately 70 licences held by all other companies). Over the past 25 years, a number of foreign companies have carried out exploration in Poland, including globally-known players such as Amoco, Texaco, Conoco and Exxon. At the same time, new exploration companies were established by Polish petrochemical giants PKN Orlen and Grupa LOTOS. At the end of 2014, 21 companies were engaged in hydrocarbon exploration in Poland. Despite this highly competitive environment, the PGNiG Group has maintained its leading position − no foreign company has independently made a material discovery or become the operator under a production licence. As regards oilfield services, a number of international companies such as Schlumberger, Halliburton, Weatherford and United Oilfield Services also operate in Poland. Despite the intense competitive pressure, companies of the PGNiG Group GEOFIZYKA Kraków S.A., GEOFIZYKA Toruń S.A. and Exalo Drilling S.A. enjoy a strong position in this market area.

1. Exploration

Exploration in Poland

In 2014, PGNiG S.A. was involved in crude oil and natural gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, both on its own and jointly with partners. Drilling work in areas covered by licences awarded to PGNiG S.A was performed on 24 wells, including 15 exploration wells, 6 research wells and 3 appraisal wells. Out of the 24 boreholes, ten were drilled in search for unconventional hydrocarbons.

In 2014, six wells were drilled with positive results, including one exploration borehole in Pomerania (drilled in the past), two exploration boreholes in the Greater Poland region, and three appraisal boreholes in the Carpathian Foothills (including one in search of unconventional deposits). 14 wells (five of which had been drilled in previous years) failed to yield a commercial flow of hydrocarbons and were abandoned.

As at December 31st 2014 (i.e. as at the reporting date – although, in accordance with the Geological and Mining Law, the final calculation of reserves is made in March), the Company's recoverable reserves were:

- 81.6 bcm of natural gas measured as high-methane equivalent,
- 18.5m tonnes of crude oil with condensate.

Exploration abroad

In Egypt, PGNiG S.A. conducted exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement (EPSA) executed with the government of Egypt of May 17th 2009. The Company held a 100% interest in the licence. As results of the exploration campaign were negative, a decision was made to terminate the licence and liquidate the Egypt branch. In 2014, final settlements with Egyptian General Petroleum Corporation (EGPC) were made.

2. Joint operations

In 2014, PGNiG S.A. conducted joint operations with other entities in licence areas awarded to PGNiG S.A., FX Energy Poland Sp. z o.o., and San Leon Energy PLC. Furthermore, PGNiG S.A. collaborated with other entities in carrying out exploration work in Pakistan and Norway.

2.1 Joint operations in Poland

On March 31st 2014, PGNiG S.A. entered into a collaboration agreement with Chevron Polska Energy Resources Sp. z o.o. covering the first stage of an unconventional hydrocarbon exploration project. The agreement envisages joint evaluation of unconventional gas resources in four exploration licence areas in south-eastern Poland, including the Zwierzyniec and Grabowiec licences held by Chevron Polska Energy Resources Sp. z o.o., and the Tomaszów Lubelski and Wiszniów–Tarnoszyn licences held by PGNiG S.A. PGNiG S.A. (operator) and Chevron Polska Energy Resources Sp. z o.o. each hold a 50% interest in the licences. In 2014, a vertical exploratory well Majdan Sopocki-1 was drilled and seismic surveys were carried out. Thus the scope of work provided for in the agreement was achieved.

On December 31st 2014, PGNiG S.A. and LOTOS Petrobaltic S.A. signed an agreement for joint operations within the Górowo Iławieckie licence area. PGNiG S.A. (operator) holds a 51% interest in the licence, and LOTOS Petrobaltic S.A. – a 49% interest.

Under the licences awarded to PGNiG S.A., work continued in the following areas:

- "Płotki" – under the agreement for joint operations dated May 12th 2000; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Płotki" – "PTZ" (the Extended Zaniemyśl Area) – under the operating agreement dated October 26th 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%;
- "Poznań" – under the agreement for joint operations dated June 1st 2004; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Bieszczady" – under the agreement for joint operations dated June 1st 2007; licence interests: PGNiG S.A. (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%;
- "Sieraków" – under the agreement for joint operations dated June 22nd 2009; licence interests: PGNiG S.A. (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%.
- "Kamień Pomorski" – under the agreement of August 14th 2013 (which came into effect in H2 2014); licence interests: PGNiG S.A. (operator) – 51%, LOTOS Petrobaltic S.A. – 49%.

Within the "Poznań" licence area, the Komorze gas field and the Lisewo-2K well in the Lisewo field were brought on stream. A new natural gas deposit was encountered by the Karmin-1 borehole. Three exploratory wells were abandoned due to low gas flows. The Sieraków-3 well within the "Sieraków" area was also abandoned because hydrocarbon production had been unprofitable.

Under licences held by FX Energy Poland Sp. z o.o. work was conducted in the "Warszawa-Południe" area (block 254 and block 255), on the basis of the joint operations agreement dated May 26th 2011. The licence interests are as follows: FX Energy Poland Sp. z o.o. (operator) – 51%, and PGNiG S.A. – 49%. In 2014, FX Energy Poland Sp. z o.o. filed an application with the Ministry of Environment declaring its relinquishment of the oil and gas exploration and appraisal licences in block 254. However, the company was granted a new oil and gas exploration and appraisal licence in block 255.

Under licences awarded to San Leon Energy PLC, work was conducted in the following areas:

- "Karpaty Zachodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (operator) – 60%, PGNiG S.A. – 40%;
- "Karpaty Wschodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG S.A. – 20%.

On October 23rd 2014, upon application from San Leon Energy PLV, the licences were extinguished, and the agreement for joint operations within the "Karpaty Wschodnie" area was automatically terminated. Two exploration wells were drilled within the "Karpaty Zachodnie" licence area and subsequently abandoned, as they failed to flow natural gas at commercial rates.

2.2. Joint operations abroad

Pakistan

PGNiG S.A. conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared in proportion to the parties' interests in the licence: PGNiG S.A. (operator) – 70%, PPL – 30%. In 2014, PGNiG S.A. began preparations to drill appraisal boreholes Rehman-2 and Rehman-3 (scheduled for completion in 2015 and 2016). PGNiG S.A. had to declare a force majeure event and suspend work on the Rizq-1 exploratory well on two occasions due to armed attacks in the region. Work on Rizq-1 was resumed in late December 2014. Production from the Rehman-1 and Hallel X-1 wells continued uninterrupted, and the extracted gas was supplied to the Pakistani transmission system.

Norway

PGNiG Upstream International AS, a PGNiG Group company, holds interests in exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea, in the North Sea, and in the Barents Sea. Jointly with partners, the company has been producing hydrocarbons from the Skarv field (Skarv project) and developing the Snadd field. In 2014, the company acquired interests in three producing fields: Morvin (6%), Vilje (24.243%) and Vale (24.243%), as well as in the Gina Krog field (8%), which is currently in the development phase. In the other licence areas, the company is engaged in exploration projects.

Hydrocarbon production under the Skarv project is carried out using a floating production, storage and offloading vessel (FPSO), which is moored in the vicinity of the field. The oil is sold directly from the FPSO vessel to Shell International Trading and Shipping Company Ltd. and transported by the trading partner's fleet of shuttle tankers. The produced gas is transmitted over the Gassled Area B System gas pipeline to the onshore terminal in Kårsto, and then redirected to Germany over the Gassled Area D System gas pipeline, where it is received by PGNiG Sales & Trading GmbH. In 2014, operations on the Skarv field yielded a total of 418 thousand tonnes of crude oil with other fractions (measured as tonnes of crude oil equivalent) and 419 mcm of natural gas.

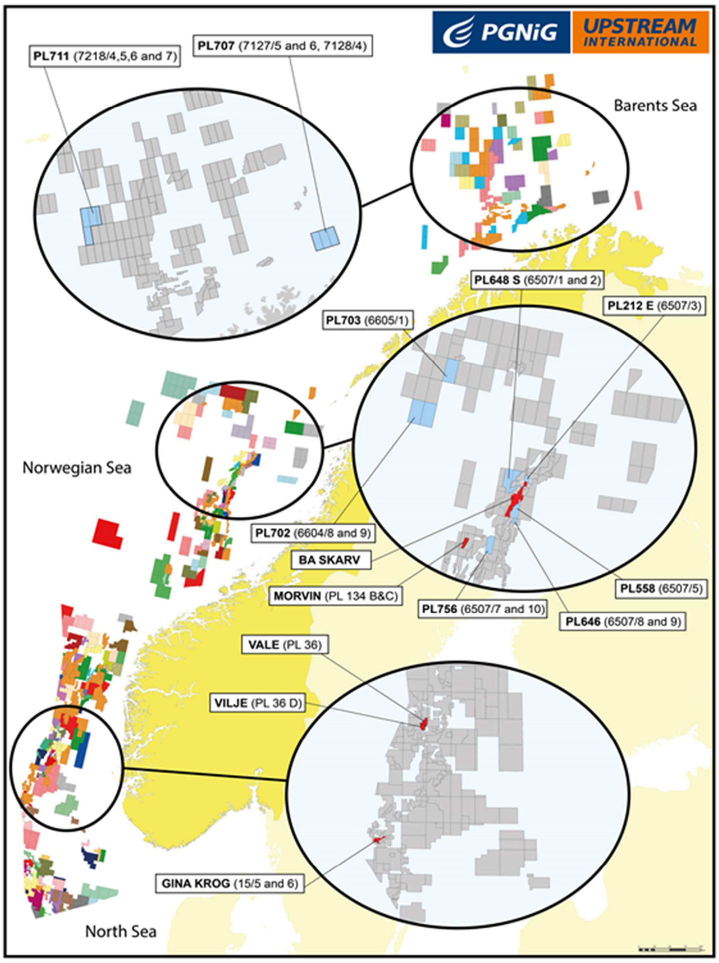
In 2014, PGNiG Upstream International AS acquired interests in four fields located on the Norwegian Continental Shelf from Total E&P Norge AS. The interests cover six licences on the following fields: Morvin, Vilje, Vale and Gina Krog. As a result of the transaction, PGNiG Upstream International AS acquired:

- a 24.243% interest in the PL36D licence (Vilje field); the remaining interests are held by Det norske oljeselskap ASA as the operator (46.904%) and Statoil Petroleum AS (28.853%),
- a 24.243% interest in the PL36 and PL249 licences (Vale field); the remaining interests are held by Centrica plc as the operator (50%) and Lotos E&P Norge AS (25.757%),
- a 6% interest in the PL136B and PL136C licences (Morvin field); the remaining interests are held by Statoil Petroleum AS as the operator (64%) and Eni Norge AS (30%),
- a 29.63% interest in the PL029C licence (representing an 8% interest in the Gina Krog field); the remaining interests are held by Statoil Petroleum AS as the operator (58.7%), Total E&P Norge AS (30%) and Det norske oljeselskap ASA (3.3%).

An independent auditor's report sets the 2P recoverable reserves of crude oil (72%) and natural gas (28%) attributable to the interests acquired by the company at 33 million boe. Consequently, PGNiG Upstream International AS' recoverable reserves in Norway grew by ca. 60%. According to operator data, production from the fields will continue for an average period of 14 years.

The interests were acquired for NOK 1,950m, with January 1st 2014 as the agreed transaction date. A significant portion of the transaction price was settled using cash flows acquired by PGNiG Upstream International AS and generated in the period between the agreed acquisition date and the date of actual settlement. Given the achieved sales targets of hydrocarbons produced from the acquired fields in 2014, reduced costs and capital expenditure, as well as favourable foreign exchange rates, the ultimate cash payment amounted to approximately NOK 843m (approximately PLN 400m at the exchange rate as at December 30th 2014), which accounted for only 43% of the purchase price. The amount was financed with an intra-Group bridge loan from PGNiG S.A.

The Morvin field is located in the Norwegian Sea, while the other fields – in the North Sea. Locations of the new fields are shown on the map below.



PGNiG Upstream International Licence Portfolio

In addition, another licensing round was concluded in 2014, as a result of which PGNiG Upstream International AS was granted the PL756 operator licence in the Norwegian Sea. As the operator, the company acquired a 50% interest in the licence. PGNiG Upstream International's licence partners are Idemitsu Petroleum Norge AS and Rocksource Exploration Norway AS, with a 25% interest each. The PL756 licence is located in a well appraised area, close to a number of producing fields, including the large Aasgard field. This licence is the second operator licence granted to PGNiG Upstream International AS on the Norwegian Continental Shelf.

Geological and geophysical analyses were performed in the PL599, PL600 and PL648S licence areas, on the basis of which the exploration risk was assessed as high, and so the company and its partners renounced the PL599 and PL600 licence areas and relinquished the PL648S licence area. As at December 31st 2014, PGNiG Upstream International AS held interests in 18 exploration and production licences on the Norwegian Continental Shelf, including two operator licences.

Also in 2014, the company continued work on the development of the Snadd field and preparation of the Skarv field for the second drilling stage, which is scheduled to commence in 2017, as well as its operations on other exploration licence areas. Among other things, it worked on evaluation of prospectivity of the PL646, PL707, PL711 and PL756 licences and was involved as a partner in drilling of an exploration borehole (ultimately classified as a dry hole and abandoned) in the PL558 licence area.

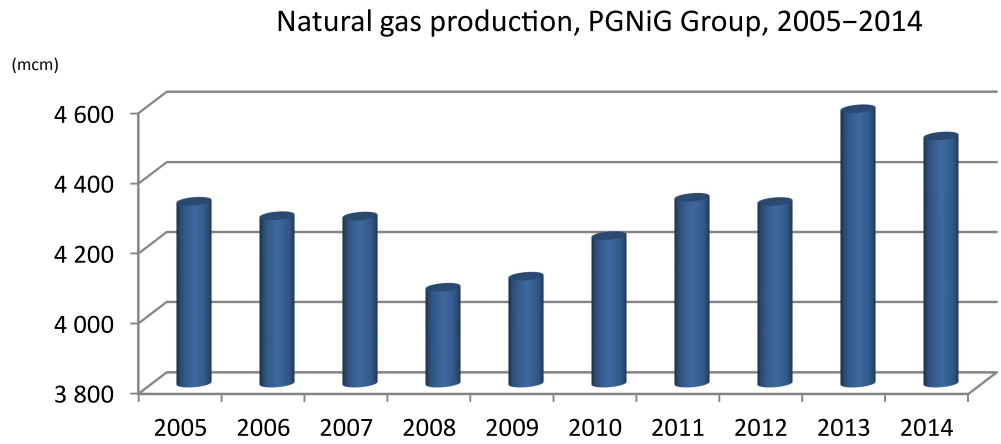
In January 2015, another licensing round was concluded, as a result of which PGNiG Upstream International AS was granted the PL799 operator licence in the Norwegian Sea. As the operator, the company acquired a 40% interest in the licence, while its partners – Statoil Petroleum AS, VNG Norge AS and Explora Petroleum AS – each received a 20% interest. The PL799 licence area is located in the vicinity of the Skarv and Snadd fields.

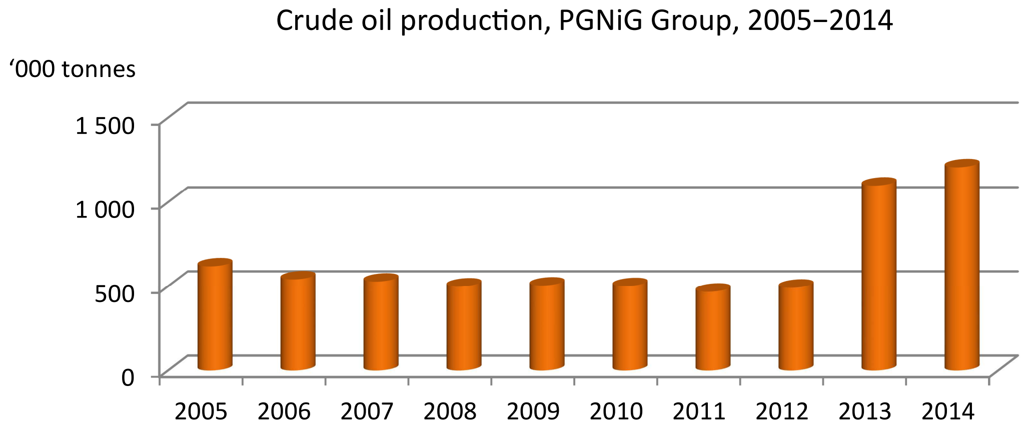
Libya

Polish Oil and Gas Company - Libya B.V., the Group's subsidiary, conducted exploration work in licence area No. 113 within the Murzuq petroleum basin in Libya, under an exploration and production sharing agreement of February 25th 2008 concluded with the Libyan government.

Due to the tense political situation and growing threat to the safety of employees, the exploration work in Libya was discontinued in January 2014.

3. Production





In 2014, the PGNiG Group conducted hydrocarbon production in Poland, in the Norwegian Continental Shelf and in Pakistan. Natural gas and crude oil in Poland is extracted by two branches of PGNiG S.A.: the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 22 sites, including 13 gas production facilities, 6 oil and gas production facilities and 3 oil production facilities. The Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 37 sites, including 20 gas production facilities, 11 oil and gas production facilities and 6 oil production facilities.

In 2014, the PGNiG Group produced a total of 4,504 mcm of natural gas (high-methane gas equivalent), of which 4,027 mcm was produced from fields in Poland, and 477 mcm from fields abroad. Production of crude oil and other fractions reached 1.207 thousand tonnes of crude oil equivalent. Natural gas and crude oil production volumes are presented in the table below.

Natural gas production volume

	Product	2014		2013
		GWh	mcm*	mcm*
1.	Natural gas, including:	49,542	4,504	4,582
a.	high-methane gas, including:	20,634	1,876	1,891
	- Zielona Góra Branch	-	-	-
	- Sanok Branch	15,983	1,457	1,551
	- Norway	4,651	419	340
b.	nitrogen-rich gas, including:	28,908	2,628	2,692
	- Zielona Góra Branch	27,393	2,490	2,574
	- Sanok Branch	879	80	87
	- Pakistan Branch	636	58	31

* Measured as high-methane gas equivalent.

Crude oil production volume

Product	Unit of measure	2014	2013
Crude oil, including:	'000 tonnes	1,207	1,099
- Zielona Góra Branch	'000 tonnes	742	766
- Sanok Branch	'000 tonnes	47	49
- Norway	'000 tonnes	418	283

In 2014, in the Sanok Branch area two wells on the already producing fields, four wells within exploratory licence areas and four new fields: Łapanów, Pogwizdów, Mołodycz and Wola Rokietnicka, were brought on stream. The total addition to production capacity is approximately 10.3 thousand cubic metres of gas per hour (high-methane gas equivalent).

In the Zielona Góra Branch area, two wells were brought on stream on the already producing fields: one well on the Radlin field and one well on the Lisewo field (in partnership with FX Energy Poland Sp. z o.o.), with a total production capacity of 3.9 thousand cubic metres per hour (high-methane gas equivalent). The Komorze field, with a production capacity of 1.0 thousand cubic metres per hour (high-methane gas equivalent), was also brought on stream in partnership with FX Energy Poland Sp. z o.o. Additionally, in 2014, one oil well was brought on stream on the new Ołobok field, with a production capacity of 15 tonnes per day.

Underground gas storage facilities

In 2014, the Exploration and Production segment used the working capacities of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. Storage capacities used to meet the needs of the Production segment are not storage facilities within the meaning of the Polish Energy Law.

The table below presents the working capacities of the underground storage facilities used by the Exploration and Production segment as at December 31st 2014.

Working capacities of the underground storage facilities used by the Exploration and Production segment

Nitrogen-rich gas	2014 GWh*	2014 (mcm)	2013 (mcm)
Daszewo (Ls)	250	30	30
Bonikowo (Lw)	1,667	200	200

*Converted to gas with a calorific value of 30 MJ/m^3

4. Sales of key products

The key products sold by the Trade and Storage segment are crude oil, high-methane gas and nitrogen-rich gas. Other products, obtained in the process of crude refining, include crude condensate, sulfur and propane-butane. Some of the produced nitrogen-rich gas is further treated into high-methane gas at the Odolanów and Grodzisk Wielkopolski nitrogen rejection units. Apart from high-methane gas, the cryogenic processing of nitrogen-rich gas yields such products as liquefied natural gas (LNG), gaseous and liquid helium and liquid nitrogen.

In 2014, the PGNiG Group’s sales of natural gas totalled 801 mcm, of which 744 mcm was sold in Poland, and 57 mcm was sold in Pakistan. In addition, the Group sold 1.169 thousand tonnes of crude oil, including other fractions. The tables below present volumes of natural gas sold directly from the fields, and sales volumes of crude oil and other fractions.

Sales of natural gas

	2014		2013
	GWh	mcm*	mcm*
Natural gas, including:	8,886	801	749
- high-methane gas	768	69	72
- nitrogen-rich gas*	8,118	732	677

*Measured as high-methane gas equivalent.

Sales of crude oil

	Unit of measure	2014	2013
Crude oil, including:	‘000 tonnes	1,169	1,106
- Poland	‘000 tonnes	780	810
- Norway	‘000 tonnes	389	296

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for about 78% of the total sales volume. PGNiG S.A. sold crude oil to Shell International Trading and Shipping

Company Ltd., Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A., TOTSA TOTAL OIL TRADING S.A. and BP Europe SE. In November 2014, PGNiG S.A. and Rafineria Trzebinia S.A. signed an annex to their agreement. Under the annex, the cost of rail transport was transferred to the buyer. Since January 2015, Rafineria Trzebinia S.A. has been responsible for crude oil transport from PGNiG S.A.'s railway terminals to relevant destinations, covering all related costs.

5. Service activities

In 2014, the Exploration and Production companies were engaged in drilling exploration, appraisal, core and production boreholes as well as boreholes required for the construction and extension of underground gas storage facilities. Other important areas of their activity included provision of specialist well servicing and geophysical services.

Exploration, appraisal and core boreholes were drilled mainly in search for hydrocarbons, but also for copper. Drilling services were rendered in Poland and abroad for both the PGNiG Group and for third-party customers. In Poland, contracts were performed for companies exploring for:
- conventional gas, e.g. for PGNiG S.A., FX Energy Poland Sp. z o.o. and Energia Karpaty Zachodnie Sp. z o.o. Sp. k.
- unconventional gas, e.g. for PGNiG S.A, Orlen Upstream Sp. z o.o. (exploration for shale gas) and the Polish Geological Institute (coalbed methane),
- unconventional crude oil, for Wisent Oil &Gas Sp. z o.o. (exploration for shale oil),
- copper deposits, for KGHM Polska Miedź S.A., Zielona Góra Copper Sp. z o.o. and Mozów Copper Sp. z o.o.

Furthermore, boreholes were drilled as part of the Kosakowo underground storage facility construction project and the Mogilno underground gas storage cavern facility extension project.

On foreign markets, drilling was conducted in exploration for conventional hydrocarbons for third-party customers, including in Uganda, Ethiopia, Pakistan, Kazakhstan, Egypt and Lithuania. Further, the segment carried out contracts for production well drilling, which were primarily performed in Poland for PGNiG S.A. and abroad for third-party customers – mainly in Kazakhstan, Pakistan and Ukraine.

The segment companies also provided specialist well services such as drilling fluid services, cementing services, coiled tubing and nitrogen unit operations, mud logging, services consisting in provision of downhole equipment and well testing, reservoir measurements and production tests, as well as remedial treatments, workovers, and well abandonment services. Well services were primarily performed for PGNiG S.A. Domestically, the main third-party customers for well services included LOTOS Petrobaltic S.A., FX Energy Poland Sp. z o.o., Orlen Upstream Sp. z o.o., Wisent Oil &Gas Sp. z o.o., Geops Deep Drilling Sp. z o.o., Przedsiębiorstwo Budowy Kopalń PeBeKa S.A., the Polish Geological Institute and Chevron Polska Energy Resources Sp. z o.o. Abroad, the company's operations included cementing services in Romania and Lithuania, coiled tubing, nitrogen unit operations and mud logging in Ukraine, as well as workovers, and well abandonment services in the Czech Republic.

In 2014, companies of the Exploration and Production segment performed geophysical services in the area of exploration geophysics (including acquisition, processing and interpretation of seismic data) and well logging. In the Polish market, their most important customers included PGNiG S.A., Chevron Polska Energy Resources Sp. z o.o., FX Energy Poland Sp. z o.o., NAFTA a.s. and Orlen Upstream Sp. z o.o. For PGNiG S.A., the Exploration and Production segment companies performed exploration geophysics services; for third-party customers, they provided both exploration geophysics and well logging services. In foreign markets, the Group performed seismic acquisition work and well logging services for customers from Hungary, Germany, Slovakia, Serbia, Tunisia, Oman, Georgia and other countries, as well as seismic data processing and interpretation services for customers from Pakistan, France, Yemen, the United Kingdom, Kenya, Cameroon and other countries.

6. Planned activities

Exploration in Poland

In 2015, PGNiG S.A. will carry out exploratory geophysical work and drilling in Poland on a number of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG S.A. on its own or jointly with partners.

The Company also intends to pursue projects focused on exploring new potential opportunities, where little appraisal has so far been made. In Pomerania, three horizontal wells will be drilled and fracked. PGNiG also plans to drill two exploratory wells into Carboniferous formations, which are a new direction of its hydrocarbon exploration.

Exploration abroad

In Pakistan, in order to verify the potential of the structure located to the north of the Kirthar discovery, PGNiG S.A. will continue drilling the Rizq-1 well and perform further work on the Rehman-2 and Rehman-3 wells.

On the Norwegian Continental Shelf, PGNiG Upstream International AS, as a project partner, will continue to produce hydrocarbons from the Skarv field and the newly acquired fields, proceed with the development of the Snadd and Gina Krog fields, and prepare for the second stage of the drilling campaign on the Skarv field. Also, PGNiG Upstream International AS intends to acquire new licence areas by participating in annual licensing rounds and by acquiring interests from other entities. In the future, the company may participate, as a partner, in drilling projects in deep-sea waters (below 1,000 metres) and in the Arctic Zone. This is connected with its interests in two licences (PL702 and PL703) in the Vøring Basin in the Norwegian Sea shelf, where sea depth exceeds 1,000 metres, and in two licences (PL707 and PL711) in the Barents Sea shelf, in the Arctic Zone.

Natural gas production

The PGNiG Group is implementing an investment programme aimed at maintaining, in a long-term perspective, its natural gas production capacity. As part of the programme, PGNiG S.A. plans to develop new deposits and wells, modernise and expand the existing gas production facilities, build new underground gas storage facilities and expand the existing ones.

Plans for 2015 provide for an annual natural gas production volume of approximately 4.5 bcm of high-methane gas equivalent with a calorific value of 39.5 MJ/cm, of which 0.4 bcm will be produced from fields on the Norwegian Continental Shelf. Within the Sanok Branch area, plans for 2015 include launch of production from two wells on the Przemyśl producing field, as well as launch of production from the new Załęże field. Within the Zielona Góra Branch area, it is planned that in 2015 the production will be launched from new wells on the Daszewo, Zaniemyśl and Wilków fields.

<u>Crude oil production</u>

The PGNiG Group estimates its 2015 crude oil output at 1.27 million tonnes, including 0.76 million tonnes produced domestically and 0.51 million tonnes produced from fields on the Norwegian Continental Shelf.

<u>Service activities</u>

In 2015, the PGNiG Group plans to provide drilling services in Poland and abroad. In Poland, the segment companies will conduct drilling for PGNiG S.A. and for third-party customers. In foreign markets, services will be provided for PGNiG S.A. in Pakistan and for third-party customers in Egypt, Kazakhstan, Pakistan, Saudi Arabia, Botswana, Czech Republic, Lithuania, and Ukraine.

Specialist oilfield services are planned to be performed in Poland chiefly for PGNiG S.A., but also for foreign companies that hold licences to explore for minerals (mainly hydrocarbons), and in foreign markets for third-party customers in Croatia, Romania, Czech Republic, Saudi Arabia, Ukraine, Lithuania, Belarus and other countries.

The segment will also provide seismic data acquisition, processing and interpretation services to PGNiG S.A. and third-party customers (including FX Energy Poland Sp. z o.o. and Orlen Upstream Sp. z o.o.). Abroad, the Group will render geophysical services in Tunisia, Oman, Pakistan, Kenya, Cameroon, Yemen, India, Georgia and EU member states (Czech Republic, Slovakia, Austria, Germany, Denmark, Hungary and Croatia).

7. Risks related to exploration and production

<u>Resource discoveries and estimates</u>

The main risk inherent in exploration activities is the risk of failure to discover resources, i.e. exploration risk. This means that not all the identified potential deposit sites actually have deposits of hydrocarbons which can qualify as an accumulation.

The reserves estimates and production projections may be erroneous due to imperfections inherent in the equipment and technology, which affect the quality of the acquired information concerning the geological factors and the characteristics of the deposit site. Irrespective of the methods applied, data on the volume and quality of commercial reserves of crude oil and natural gas is always an estimate. Actual production, income and expenses relating to a given deposit may significantly differ from the estimates. The weight of this risk is further increased by the fact that in the full business cycle the period from the commencement of exploration to the launch of production from a developed field takes six to eight years, while the production lasts from 10 to 40 years. Formation characteristics determined at the stage of preparing the relevant documentation are reviewed after production starts. Each downgrade of the size of the reserves or production quantities may lead to a lower revenue and adversely affect the PGNiG Group's financial performance.

<u>Exploration for unconventional deposits of gas</u>

The risk associated with exploration for unconventional deposits of gas in Poland relates to the lack of confirmed presence of *shale gas* and *tight gas*. Furthermore, even if existence of in-place petroleum is confirmed, its production may prove uneconomic due to insufficient gas recovery rates and high investment expenditure necessary to drill wells and construct production facilities. Another material factor is connected with difficult access to unconventional gas plays given the environmental regulations and the necessity to obtain the landowners' consent for access to the area.

Delayed work

Under the applicable Polish legal regulations, obtaining a licence for exploration for and appraisal of crude oil and natural gas deposits lasts from one to one and a half years. On foreign markets, such procedures may take even two years from the time that the winning bid is awarded in a licensing tender for until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and, in some cases, requirements related to protection of archaeological sites, and abiding by the regulations governing tenders held to select a contractor, which delays execution of an agreement with a contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long. These factors create the risk of delays in the start of exploration work.

Formal and legal hurdles beyond PGNiG S.A.'s control include:
- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in having investment projects incorporated into the local zoning plans;
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions or building permits;
- amendments to the current investment project;
- obstacles in obtaining permission from land owners to enter the site.

These factors significantly delay implementation of investment projects and commencement of on-site construction work. Further, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently protracts the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploratory work is capital intensive, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto prices of casing pipes and lifting casing used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploratory work. Moreover, profitability of foreign exploration projects depends to a significant extent on the prices of oil derivative products and on exchange rates. To reduce drilling costs, PGNiG S.A. introduced the *daily rate* system into its drilling contractors selection procedure in 2011.

Competition

Both on the Polish market and abroad there is a risk of competition from other companies in the area of acquisition of licences for exploration for and appraisal of hydrocarbon deposits. Certain competitors of the PGNiG Group, especially those active globally, enjoy strong market positions and have greater financial resources than those available to the Group. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than the Group could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

Political and economic situation in the regions where the PGNiG Group operates

In some countries where the PGNiG Group conducts exploration activities there is a number or risks, which may lead to a limitation, suspension or even discontinuation of the exploration and production activities. These risks include armed conflicts, terrorist attacks, social or political unrest, internal conflicts and civil disturbance.

In 2011, all non-Libyan employees of POGC-Libya B.V. were evacuated from the country following the occurrence of a force majeure event. Operations were resumed in the second half of 2012. A similar situation took place in January 2014. All Polish employees working in the Murzug 113 licence area were withdrawn to Poland. The site was sealed and secured by Libyan government forces and was left to be overseen by local subcontractors.

In 2014 in Pakistan, a group of armed members of the Rind tribe blocked access to the Rizq-1 well, preventing any drilling work. For this reason, PGNiG S.A. suspended its operations in the area and declared a force majeure event. After the situation stabilised, the drilling was resumed in October 2014. However, on the night of November 12th and November 13th, the area came under a gun fire attack that lasted for about half an hour. Following the incident, agreements were signed with local residents for the provision of security services. Also, consultations were held with well service companies (mainly Exalo Drilling S.A.) and the commanders of Rangers units, as a result of which the area was placed under increased security. Despite these measures, work on the Rizq-1 well was disrupted on two more occasions. Consequently, PGNiG S.A. again suspended the well operations and declared force majeure on November 28th 2014, evacuating its staff from the area on November 30th. Work on Rizq-1 was resumed on December 25th 2014.

In certain countries, operations of exploration companies may be hindered by a lack of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Also, frequent changes to national legislation may lead to suspending or limiting the scope of exploration.

Unforeseen events

Hydrocarbon deposits developed by the PGNiG Group are usually located at great depths, which involves extremely high pressures and, in many cases, the presence of hydrogen sulfide. Consequently, the risk of hydrocarbon blowout or leakage is very high, which in turn may pose a threat to people (workers and local population), natural environment and production equipment.

The PGNiG Group and its partners are engaged in exploration for and production of hydrocarbons on the Norwegian Continental Shelf. Offshore operations are much more complicated than those carried out onshore. If a serious failure or uncontrolled release of hydrocarbons occurs at sea, remediation can be very costly.

Safety, environmental protection and health regulations

Ensuring compliance with environmental laws in Poland and abroad may significantly increase PGNiG S.A.'s operating expenses. Currently, PGNiG S.A. incurs significant capital expenditure and costs on ensuring compliance of its operations with ever more complex and stringent regulations concerning safety and health at work, as well as environmental protection. The act of May 18th 2005 amending the Natural Environment Protection Law and certain other acts (Dz.U. No. 113, item 954 of June 27th 2005) rendered the regulations governing the execution of projects which might affect Natura 2000 sites more stringent and enhanced the environmental protection-related requirements with regard to entering the areas of the occurrence of protected plant species and habitats of protected animals.

Section VIII: Trade and Storage

The principal activity of the segment is trade in natural gas. Gas sold by the segment sells is mainly imported, but also domestically produced. Sale of natural gas through the distribution and transmission network is regulated by the Polish Energy Law, and gas prices are determined based on tariffs approved by the President of the Energy Regulatory Office (except for the natural gas sold at the Polish Power Exchange). The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates seven underground gas storage facilities (Brzeźnica, Husów, Mogilno, Strachocina, Swarzów, Wierzchowice and Kosakowo).

The PGNiG Group is the largest supplier of natural gas in Poland. According to the Energy Regulatory Office, PGNiG S.A.'s share in total sales of natural gas in 2013 was 94.4%. In 2014, natural gas was supplied to customers mostly by two companies of the PGNiG Group: PGNiG S.A. and its subsidiary PGNiG Obrót Detaliczny Sp. z o.o., which commenced its operations on August 1st 2014. Thus, the company has become the largest retail supplier of natural gas, while PGNiG S.A. has maintained its leading position on the wholesale market. However, due to the ongoing gas market deregulation and growing activity of other players, in the period from January 2013 to December 2014 PGNiG's share in gas imports dropped by 12 pp., down to 79.7%.

1. Purchases of natural gas

In 2014, the PGNiG Group purchased gas from abroad and, to a limited extent, from domestic suppliers.

PGNiG S.A. bought natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022;
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016;
- Individual Agreement with Vitol S.A. for sale of natural gas, dated May 13th 2011, effective until October 1st 2014.

PGNiG Sales & Trading GmbH purchased natural gas on the German market, mainly in OTC transactions on the *NCG* (*NetConnectGermany*) and *Gaspool* virtual trading platforms. The company also purchased gas on the *European Energy Exchange* (*EEX*).

In 2014, to fulfil its trading obligations, the PGNiG Group purchased a total of 14.531 mcm of natural gas, 76% of which was imported from foreign suppliers. The table below presents the structure of natural gas purchases from suppliers, measured as high-methane gas equivalent.

Structure of natural gas purchases

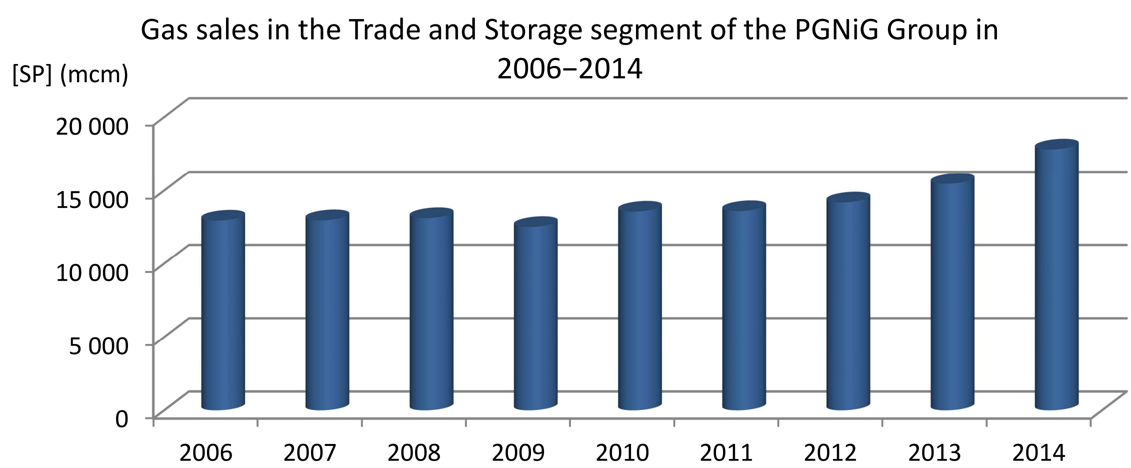
	2014			2013	
	GWh	mcm	%	mcm	%
Foreign suppliers:	122,830	11,086	76%	11,906	97%
- Gazprom Export	90,733	8,097	73%	8,733	73%
- Other foreign suppliers	32,097	2,989	27%	3,173	27%
Domestic suppliers:	37,849	3,445	24%	390	3%
- Power exchange	35,144	3,201	93%	0	0%
- Other domestic suppliers	2,705	244	7%	390	100%
Total	160,679	14,531	100%	12,296	100%

New contracts

On December 9th 2014, PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) executed a supplementary agreement to the contract for sale of liquefied natural gas (LNG) of June 29th 2009. The supplementary agreement alters the terms on which the contract is to be performed throughout 2015. The gas volumes originally intended for PGNiG S.A. in 2015 will be transferred by Qatar Liquefied Gas Company Limited (3) to other markets. PGNiG will cover the potential difference between the LNG price specified in the contract and the market price obtained by Qatar Liquefied Gas Company Limited (3).Should the price be lower than PGNiG finds satisfactory, any unsold LNG supplies will be shifted to subsequent years of the contract. The supplementary agreement also specifies the terms on which PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) will agree LNG supplies in 2015, once the Świnoujście terminal achieves full operational functionality. The agreement eliminates the risk of PGNiG S.A. having to pay for uncollected LNG in 2015 under the *take or pay* clause.

On November 1st 2014, PGNiG S.A. requested OOO Gazprom Eksport to renegotiate the price of natural gas supplied by OOO Gazprom Eksport under the contract for sale of natural gas to Poland, dated September 25th 1996, with a view to reducing the price.

2. Sales of natural gas



The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. The PGNiG Group sold gas to customers in Poland and abroad (chiefly on the German market), and on the power exchanges in Poland and Germany.

In order to meet the requirement to sell gas on the exchange market, in August 2014, PGNiG Obrót Detaliczny Sp. z o.o. launched its operations. The company procures gas mainly at the Polish Power Exchange, and later resells it to customers. PGNiG Obrót Detaliczny Sp. z o.o. serves customers who in the previous year bought no more than 25 mcm of natural gas. End-user agreements were automatically transferred to PGNiG Obrót Detaliczny Sp. z o.o. by way of universal succession. Launch of PGNiG Obrót Detaliczny Sp. z o.o.’s operations will ensure adequate demand for natural gas sold on the power exchange and will enable fair competition between the PGNiG Group’s subsidiary and other participants of the Polish gas market.

Sale of natural gas at the Polish Power Exchange by PGNiG S.A. and purchase of natural gas at the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o. are not eliminated on consolidation.

In 2014, gas sales in the Trade and Storage segment reached 17,808 mcm , 16,063 mcm of which was sold on the domestic market. Compared with 2013, gas sales increased by approximately 15%. The increase was attributable mainly to PGNiG Obrót Detaliczny Sp. z o.o.’s launching its operations, and to a substantial increase in PGNiG S.A.’s sales at the Polish Power Exchange (intercompany transactions executed at the Polish Power Exchange are not subject to elimination). The table below presents sales of natural gas in the Trade and Storage segment (measured as high-methane gas equivalent).

Sales of natural gas

	2014		2013
	GWh	mcm	mcm
Natural gas, including:	197,523	17,808	15,465
- high-methane gas	191,819	17,289	14,940
- nitrogen-rich gas*	5,704	519	525

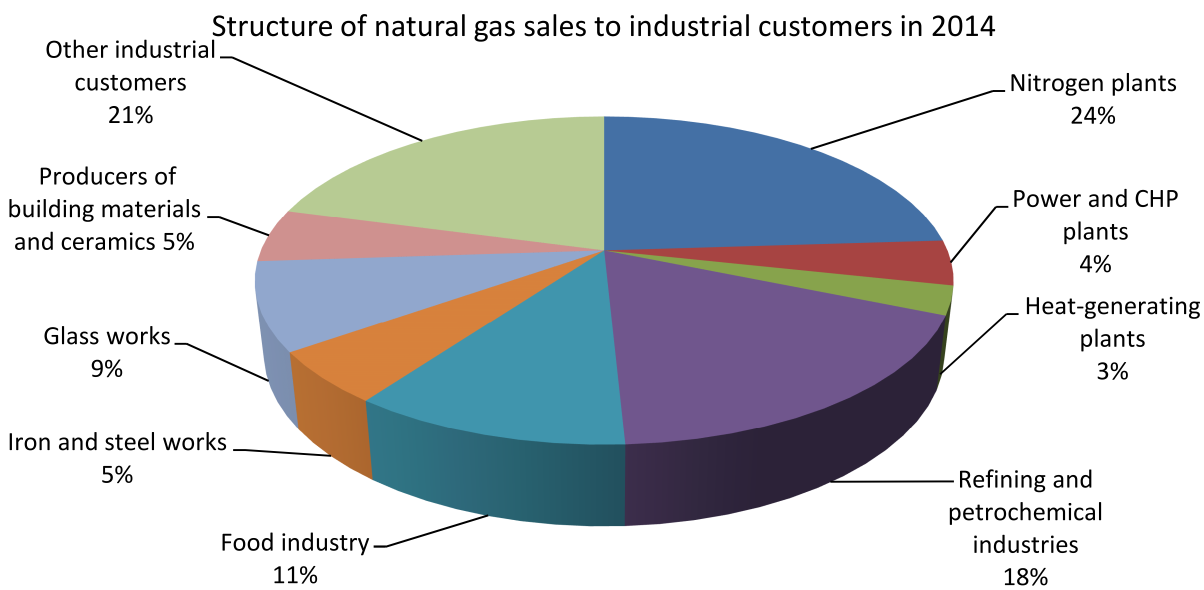
*Measured as high-methane gas equivalent.

On the domestic market, gas was purchased primarily by industrial customers (mainly in the chemical, oil refining, petrochemical and metallurgical sectors) and by households. The latter were identified as the largest customer group (approximately 6.6m), accounting for 97% of the entire PGNiG Group customer base. Industrial customers had the largest share in the sales volume. The table below presents the structure of sales of natural gas (measured as high-methane gas equivalent) by customer groups.

Gas sales by customer groups

	2014		2013
	GWh	mcm*	mcm*
Industrial customers	80,107	7,189	8,100
Trade and services	27,167	2,491	2,748
Households	40,854	3,672	3,969
Wholesale customers	2,123	197	231
Exports	-	-	84
Exchange	47,272	4,259	333
Total	197,523	17,808	15,465

*Measured as high-methane gas equivalent.



In 2014, the PGNiG Group sold 1,745 mcm of natural gas on foreign markets, primarily in Germany, where households and SME's were the largest customer groups.

<u>New contracts</u>

On January 30th 2014, PGNiG S.A. and KGHM Polska Miedź S.A. signed an annex to the comprehensive gas fuel supply contract of July 30th 2010 for the period until June 30th 2033. Under the annex, the annual volume of gas supplies was reduced from 266 mcm to 41.5 mcm. The change follows from a decision by KGHM to reduce the output of co-generated electricity and heat due to changes in the co-generation support mechanisms and low prices of electricity. The estimated value of the annexed contract is approximately PLN 830m. The parties may restore the original supply volume in the future. The parties also signed annexes to three other contracts for gas fuel supplies to KGHM, i.e. the contracts of September 25th 2001, January 4th 1999, and October 1st 1998. The annexes changed only the duration of the contracts, from indefinite term to the period until June 30th 2033. The estimated aggregate value of the three contracts over their entire term is approximately PLN 2.8bn.

3. Electricity

In 2014, PGNiG S.A. engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market under EFET (European Federation of Energy Traders) standard agreements and through brokers, and also at the Polish Power Exchange. In Germany, the Company engaged in spot contract trading on the EPEX (European Power Exchange) Spot market, and in the inter-system Poland-Germany exchange (between the areas covered by PSE and 50 Hertz Transmission).

PGNiG Sales & Trading GmbH engaged in electricity trading in Germany on the EPEX Spot, EEX Power Derivatives and OTC markets.

Sales of electricity

In 2014, in the domestic market the PGNiG Group sold electricity to business customers (tariff groups A, B and C), and to households (tariff group G). The Company sells electricity with fixed price guarantee (for periods as long as until 2016) and offers full balancing of customers' electricity requirements. In 2014, the PGNiG Group continued its promotional campaign "Energia w dwupaku" ("Energy double play"), as part of which it offers to subsidise its customers' electricity bills. This offer is addressed primarily to small and medium-sized companies which already buy gas from the Group or want to sign gas-supply contracts with PGNiG.

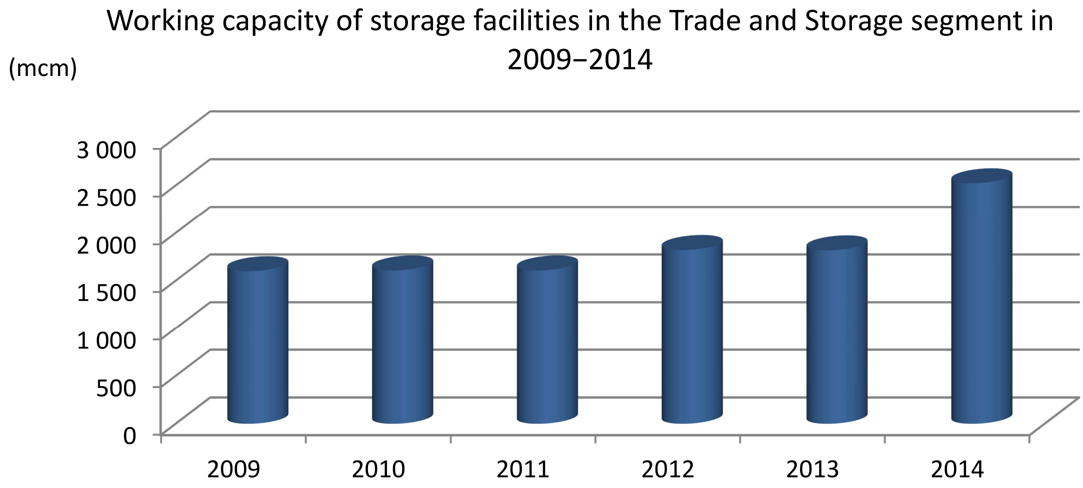
The Group also sold electricity to end users on the German market, where its customers included chiefly small and medium-sized companies, as well as households.

In 2014, the Group sold 10,153 GWh of electricity, that is 5,427 GWh (115%) more than in 2013. This increase was attained thanks mainly to more active trading at the Polish Power Exchange as well as the EPEX Spot market. Sales in the domestic market reached 5,645.2 GWh. The table below presents sales of electricity by customer group.

Sales of electricity (GWh)

	2014	%	2013	%
End user	259	3%	64	1%
Trading companies	3,186	31%	1,528	32%
Balancing market	424	4%	455	10%
Exchange	6,284	62%	2,679	57%
Total	10,153	100%	4,726	100%

4. Storage



The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno and Kosakowo underground gas storage cavern facilities. A part of the working capacity of the Mogilno facility, which was made available to OGP GAZ-SYSTEM S.A., is not a storage facility within the meaning of the Polish Energy Law.

Short-term peak fluctuations in demand for natural gas may be balanced by the supplies from the Mogilno and Kosakowo facilities, where gas is stored in worked-out caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica facilities are used to minimise the effect of changes in demand for natural gas in the summer and winter seasons, to meet the obligations under the take-or-pay import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under contracts for gas deliveries to customers’ premises.

The capacities of the Wierzchowice, Husów, Mogilno and Strachocina facilities are also used by PGNiG S.A. to meet its obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007.

Storage capacities of PGNiG S.A.’s facilities are managed by Operator Systemu Magazynowania Sp. z o.o.

<u>Tariff</u>

Until July 16th 2014, Operator Systemu Magazynowania Sp. z o.o. carried out settlements relating to storage services based on the rates provided for in the amendment to Gas Fuel Storage Tariff No. 1/2012 of December 17th 2012. On July 2nd 2014, the President of the Energy Regulatory Office approved Gas Fuel Storage Tariff No. 1/2014. The new tariff is effective from July 17th 2014 until March 31st 2015. The tariff takes account of the new storage capacities made available at the Kosakowo cavern facility, as well as expanded capacities of the Wierzchowice and Strachocina facilities. Furthermore, the tariff provides for making settlements with customers in energy units starting from August 1st 2014.

Licence

By way of a decision of May 16th 2014, the President of the Energy Regulatory Office expanded Operator Systemu Magazynowania Sp. z o.o.'s licence to reflect the increased working capacities of Wierzchowice (up from 575 mcm to 1,200 mcm) and Strachocina (up from 330 mcm to 360 mcm) facilities, and to include the Kosakowo cavern facility (51.2 mcm).

In connection with the completed extension of the Husów underground gas storage facility and construction of new caverns at the Mogilno and Kosakowo facilities, on January 16th 2015 the Company filed an application with the President of the Energy Regulatory Office requesting an amendment of the licence with respect to the designation of working capacities of these facilities. The newly available storage capacities will include 150 mcm at the Husów facility, 60.31 mcm at the Mogilno cavern facility and 61.2 mcm at the Kosakowo cavern facility.

Storage capacities made available

The new storage capacities of the Strachocina and Wierzchowice facilities began to be used to provide storage services on May 20th 2014, while the Kosakowo cavern facility launched its services on July 17th 2014.

As at December 31st 2014, the PGNiG Group made available a total of 2,523.5 mcm of working storage capacity for third party access and to OGP GAZ-SYSTEM S.A.; of this volume, 2,502.0 mcm was made available under long-term agreements and 21.5 mcm – under short-term agreements. 0.6 mcm is the technical reserve capacity. The working capacities and working capacities made available as at December 31st 2014 are presented in the table below.

Working capacities and working capacities made available at the segment's storage facilities

	Working storage capacities (mcm)	Working storage capacities made available (mcm)	Working storage capacities made available (GWh)*
Brzeźnica underground gas storage facility	65.0	65.0	713
Husów underground gas storage facility	350.0	350.0	3,840
Mogilno underground gas storage cavern facility	407.9	407.5	4,471
Kosakowo underground gas storage cavern facility	51,2	51.0	560
Strachocina underground gas storage facility	360.0	360.0	3,950
Swarzów underground gas storage facility	90.0	90.0	988
Wierzchowice underground gas storage facility	1,200.0	1,200.0	13,166
Total	2,524.1	2,523.5	27,688

*Converted to gas with a calorific value of 39.5 MJ/m^3

5. Planned activities

Purchases of natural gas

In 2015, PGNiG S.A. will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and under short- and medium-term gas supply contracts with European suppliers. With a view to optimising the costs of gas procurement, the Company will purchase natural gas on the German market, under short-term contracts. The gas will be delivered using the virtual reverse flow service on the Yamal gas pipeline. In 2015, the Group expects to receive the first supplies of LNG under the contract with Qatar Liquefied Gas Company Limited (3). The actual date when supplies to customers are launched depends on the Świnoujście regasification terminal achieving full operational functionality.

Co-generation support mechanism

On April 30th 2014, the Act Amending the Energy Law and Certain Other Acts came into force and reinstated the co-generation support mechanism. Under the Act, energy utilities selling electricity to end users are obliged to purchase and redeem certain number of certificates of origin for electricity produced by co-generation. The reinstated mechanism, which supports CHP plants, creates an opportunity for PGNiG S.A. to increase the volume of gas sold in this segment.

Storage

In 2015, PGNiG S.A. will continue work on extending the Mogilno cavern facility and will commence to extend the Brzeźnica facility. The Company will also continue the construction (begun in 2007) of the Kosakowo underground gas storage cavern for high-methane gas.

6. Risks related to trade and storage

Deregulation of natural gas prices

The PGNiG Group is the largest supplier of natural gas in Poland. However, the pending deregulation of the Polish gas market is bound to trigger major changes, in the market itself and in the related legal framework. In 2012, a natural gas market was launched on the Polish Power Exchange. Under a decision of the President of the Energy Regulatory Office, gas trading on the exchange is exempt from the tariff obligation. Furthermore, it is expected that prices of gas for end users will be gradually liberalised as the process of deregulation of the natural gas market in Poland advances. The first customer group in respect of which the tariff requirement will be disapplied includes customers who purchased more than 25 mcm of natural gas in the previous calendar year.

As regards gas trading on the Polish Power Exchange, there is a risk that revenues from sale of natural gas will be lower than the cost of its purchase, as a result of the growing disparity between market prices of gas and of petroleum products, which still influence the prices in long-term import contracts.

Competition

Regardless of the gas price liberalisation, in 2014 PGNiG S.A.’s customers increasingly often used alternative natural gas suppliers. This trend was particularly prevalent among major industrial customers. The situation was caused mainly by the prices of natural gas on western markets, which were lower than prices in PGNiG S.A.’s tariff. The rate at which this trend continues indicates that failure to deregulate prices for this customer group strengthens the risk that the volumes of gas sold by PGNiG S.A. will decrease. This risk also applies to PGNiG Obrót Detaliczny Sp. z o.o. Companies engaged in competitive activities offer (besides traditional network supplies) modern solutions with respect to natural gas supplies with the use of liquefied natural gas (LNG). They also sell natural gas and electricity in a bundle. Intensive efforts of competitors to win over both existing and potential customers of PGNiG Obrót Detaliczny Sp. z o.o. pose a real threat of customer loss in the future.

Take-or-pay gas delivery contracts

PGNiG S.A. is a party to three long-term take-or-pay contracts for gas fuel deliveries to Poland. The most important of these are the contracts with OOO Gazprom Export and Qatar Liquefied Gas Company Limited (3). Assuming that PGNiG S.A.'s customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas, currently the most attractively priced. In the event of loss of market share by PGNiG S.A., there is a risk that the Company would be forced to look for new ways to utilise the surplus gas volumes in its portfolio. Otherwise, the Company might have to pay for the gas it has not collected (under the take or pay clauses) or sell its excess volumes at negative margins.

On December 9th 2014, PGNiG S.A. and Qatar Liquefied Gas Company Limited (3) executed a supplementary agreement to the contract for sale of liquefied natural gas (LNG) of June 29th 2009. The agreement eliminates the risk of PGNiG S.A. having to pay for uncollected LNG in 2015 under the take or pay clause.

Another risk is that with the existing contract terms and market conditions, the tariffs approved by the President of the Energy Regulatory Office will not cover PGNiG S.A.'s weighted average cost of gas purchase.

Disruptions to gas supplies from countries east of Poland

In the period from September to December 2014, quantities of natural gas supplied by OOO Gazprom Export were lower than those ordered by PGNiG S.A. To meet customer demand for gas and to continue gas injection into underground storage, the Company imported the missing volumes from the west (through Mallnow, Lasów) and the south (Cieszyn). Moreover, in late October the Company started withdrawing gas from underground storage as part of the commercially available capacities. Given the continuing political instability in Ukraine, there is a risk of further limitations in gas supplies.

Obligation to diversify imported gas supplies

The Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies prescribes the maximum share of gas imported from a single country in total gas imports in a given year. In 2015−2018, the share may not exceed 59%.

In previous years, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the diversification requirement in 2007, 2008, 2009, 2010 and 2011. In a letter of April 28th 2014, the President of the Energy Regulatory Office notified PGNiG S.A. of administrative proceedings being instigated to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2012.

As long as the Regulation is not amended, the President of the Energy Regulatory Office will be able to impose fines on the Company for failing to comply with the diversification requirement until gas starts to be supplied from other sources (e.g. through the LNG terminal). For failing to comply with the obligation to diversify supplies of imported gas in 2007−2008, the President of the Energy Regulatory Office imposed a fine of PLN 2,000,000 on the Company. The Polish Court of Competition and Consumer Protection reduced the fine to PLN 1,500,000. Having examined PGNiG S.A.'s appeal, on January 14th 2015, the Warsaw Court of Appeals issued a decision reducing the fine further, to PLN 500,000. On January 30th 2015, the Company paid the fine. Following receipt of the written statement of reasons from the Court of Appeals, PGNiG S.A. will consider lodging an appeal in cassation.

Section IX: Distribution

The segment's principal business activity consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane-butane and coke-oven gas over the distribution network. Also, the segment is engaged in extending and upgrading the gas network and connecting new customers to the existing network and to new sections of the network.

Gas distribution services are rendered by Polska Spółka Gazownictwa Sp. z o.o. As the Distribution System Operator, the company conducts its business activities in the Provinces of: Poznań, Szczecin, Gdańsk, Bydgoszcz, Warsaw, Łódź, Białystok, Kraków, Rzeszów, Kielce, Lublin, Katowice, Opole, Wrocław, Zielona Góra and, partially, in the Province of Olsztyn. The company holds a dominant share in the market, supplying gas to customers all over the country. For the time being, there are no circumstances that could adversely affect the company's competitive position and performance.

1. Segment's operations

Until July 31st 2014, all settlements of Polska Spółka Gazownictwa Sp. z o.o. with its customers were performed based on Tariff No.1 for Gas Fuel Distribution Services and LNG Regasification Services, as approved by the President of the Energy Regulatory Office on December 17th 2013. In connection with the energy-unit-based settlement system, implemented as of August 1st 2014, the President of the Energy Regulatory Office, by virtue of a decision of June 18th 2014, approved Tariff No. 2 for Gas Fuel Distribution Services and LNG Regasification Services, effective from August 1st to December 31st 2014.

On December 17th 2014, the President of the Energy Regulatory Office approved Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services to be effective from January 1st to December 31st 2015. The new tariff applies to settlements related to distribution services provided in specific conditions and specifies a uniform capacity range, based on which allocation to tariff groups is made for customers in whose case the pressure at the point of fuel offtake exceeds 0.5 MPa. The average distribution service charge rates have increased by 3%.

The Distribution Grid Code for Polska Spółka Gazownictwa Sp. z o.o. approved on December 23rd 2013 by the President of the Energy Regulatory Office had been effective until July 31st 2014. On July 29th 2014, the President of the Energy Regulatory Office approved a new Distribution Grid Code, which has been in effect since August 1st 2014. The new Distribution Grid Code provides for a change in the settlement system. On September 30th 2014, the company applied to the President of the Energy Regulatory Office for approval of a draft Distribution Grid Code changing the rules of cooperation with operators of other distribution systems.

In 2014, Polska Spółka Gazownictwa Sp. z o.o. continued 18 projects involving construction, extension and modernisation of its distribution networks, for which agreements for EU co-financing under the Infrastructure and Environment Operational Programme had been signed. The key projects included:

- Construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn, and distribution network roll-out in the municipalities; in 2014, project design documents continued to be drafted for stage II of construction of the high-pressure gas pipeline from Szczytno to Rybno and the high-pressure gas pipeline from Młynowo to Muławki; construction work was also continued on the high-pressure gas pipeline from Rybno to Młynowo and on the pressure reduction station in Mikołajki; construction was completed of the pressure reduction station in Muławki near Kętrzyn; work was also continued on the construction of grid connections in the project area;

- Construction of the south-eastern gas supply line for the city of Gdańsk, and distribution network roll-out in Wiślinka and Wyspa Sobieszewska; in 2014, work continued on project design documentation for the distribution network roll-out in Wiślinka, the Żuławy municipalities and Wyspa Sobieszewska; work was also continued on the construction of grid connections in the project area;
- Construction of the DN 300 high-pressure gas network connecting Brodnica, Nowe Miasto Lubawskie and Iława, and distribution network roll-out. The project involves construction of high-pressure gas pipelines from Brodnica to Nowe Miasto Lubawskie with a pressure reduction station, and from Nowe Miasto Lubawskie to Iława, as well as medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętnik; in 2014, construction work was continued on the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage I), project design documentation was completed for the medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętnik and the high-pressure gas pipeline from Brodnica to Nowe Miasto Lubawskie (stage II) with a pressure reduction station in Kurzętnik; work also continued on the design and cost estimate documentation for the high-pressure gas pipeline from Nowe Miasto Lubawskie to Iława and the medium-pressure gas pipeline from Dziarny to Iława; grid connections were also carried out in the project area;
- Distribution network roll-out in Blachownia and Herby. Due to problems with the acquisition of real property titles, the scope of the project was reduced to distribution network roll-out in Herby and Blachownia, i.e. approximately 3 km of high-pressure gas pipelines, approximately 43 km of medium-pressure pipelines and two gas stations; in 2014, design work continued on the high-pressure gas pipeline and a 3.5 km long section of the medium-pressure pipeline in Herby; construction also commenced of a pressure reduction station in Aleksandria and medium-pressure gas networks in Herby and Blachownia;
- Distribution network roll-out in the Włodawa area. The project comprises construction of a 58 km high-pressure gas pipeline from Kamień to Włodawa, with a 43 km medium-pressure gas network and three pressure reduction stations; in 2014, construction of the high- and medium-pressure gas pipelines with auxiliary infrastructure (stage I, II and III) was completed; construction work continued on a 24 km medium-pressure pipeline in Włodawa (stage IV of the work scope covered by the agreement for co-financing with EU funds);
- Distribution network roll-out in the Włoszczowa and Małogoszcz municipalities. The scope of the project was reduced; currently, the project involves the construction of a 44 km high-pressure gas pipeline with pressure reduction stations and distribution node (stage I), as well as construction of a 9 km medium-pressure gas network (stage II); in 2014, construction and assembly work was completed for the both stages of the project;
- Distribution network roll-out in the Chęciny and Sitówka Nowiny municipalities. The project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 63 km medium-pressure gas pipeline network with connections and gas governor stations; in 2014, construction work was completed on stage I of the project, which included construction of high- and medium-pressure pipelines with auxiliary infrastructure; at the same time, design work continued and construction and assembly work commenced on stage II;
- Natural Gas – Energy for Future Generations project, and distribution network roll-out in the Osiek and Rypin municipalities. The project involves construction of a medium-pressure gas pipeline with a total length of ca. 50 km, running through the Osiek and Rypin municipalities; in 2014, construction of the medium-pressure gas pipeline in Osiek was completed and construction of the medium-pressure gas pipeline in Rypin commenced; work also continued on project design documents for the medium-pressure pipeline in Rypin;
- Distribution network roll-out in selected localities in the Strzelin and Wiązów municipalities, Strzelin county. The project involves construction of high-pressure and medium-pressure gas pipelines with connections, two pressure reduction stations, as well as connections and a pressure reduction station for a key customer; in 2014, project design work on the high-pressure gas network was completed, and construction and assembly work started on all stages of the project.

In 2014, the Company was also implementing ten investment projects under the Regional Operational Programmes; eight of them have been completed.

In addition, in 2014 there were projects financed directly by the Company. Key among these were:

- Continued design work on the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski;
- Continued work on the upgrade of the Łódź Ring, including the upgrade of the high-pressure gas pipeline from Konstantyna to Meszcze. The project involves a series of tasks designed to improve the technical condition of the gas network, and also provides for redevelopment of ca. 52 km of gas pipelines, overhaul and upgrading work on gas stations on the gas pipelines of the Łódź Ring and the construction of high-pressure regulating stations; execution of the individual stages of the project is scheduled until 2020; in 2014, work was completed on the Brzezińska station, Łódź-Olechów high-pressure station and high-pressure station in Klęk; and reconstruction of the block/bleed/connection system on the high-pressure gas pipeline in Konstantyna and Łódź (ul. Maratońska); in addition, design work was continued on the Łódź–Smulsko high-pressure gas station, construction of the block/bleed/connection system on the high-pressure gas pipeline from Rzgów to the Pabianice block system in Ksawerów; construction and reconstruction of high-pressure gas stations in Niewiadów and Piotrków Trybunalski commenced;
- Continued design work on the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce. Development of project design documents is planned to be completed by the end of 2015;
- Continued design work on the upgrade of a 21 km section of the high-pressure gas pipeline from Lubienia to Parszów;
- Continued design work on the upgrade of a 5 km Jasło section of the high-pressure gas pipeline from Warzyce to Gorlice; construction and assembly work on the remaining 14.2 km of the pipeline was completed;
- Distribution network roll-out in Przasnysz and Chorzele. The project involves construction of a high-pressure reduction station, two increased medium-pressure reduction stations, a 65 km increased medium-pressure pipeline and a 7 km medium-pressure pipeline; in 2014, project design work was completed on the high-pressure reduction station and increased medium pressure station; design work continued on the gas stations and increased medium-pressure gas mains;
- Extension of high-pressure stations and gas mains fed from the Warsaw Ring. The project is designed to improve the transmission capacity and security of gas supplies within the city of Warsaw; the project involves construction of the Sękocin high-pressure station (completed in 2014), Jabłonna high-pressure station, Sokołów high-pressure station, Ząbki high-pressure station and a medium-pressure gas pipeline with a total length of ca. 11 km.

PSG Sp. z o.o. also connected new customers to the gas grid. In 2014, the number of newly connected customers was 80,168. Major projects in this area included:

- Connecting PGE Górnictwo i Energetyka S.A., Zespół Elektrociepłowni Bydgoszcz Branch, to the gas network. The project involves construction of high-pressure gas pipelines with a total length of ca. 53 km and construction of a high-pressure metering station; in 2014, project design work was carried out on an 8 km high-pressure gas pipeline and high-pressure metering station (stage I); as PGE Górnictwo i Energetyka Konwencjonalna S.A. abandoned stage II of the project, i.e. construction of a 45 km high-pressure gas pipeline, work on the pipeline was discontinued;
- Connecting the Michelin Polska S.A. Production Plant to the gas network. The project involves construction of a 22 km high-pressure gas pipeline, as well as construction of a high-pressure metering station and a 3 km high-pressure connecting pipeline; in 2014, design work was carried out; as Michelin Polska S.A. terminated the agreement for connecting the Production Plant to the gas network, the project was discontinued;
- Commencement of distribution network roll-out in Bielsk Podlaski. The project involves connecting Miejskie Przedsiębiorstwo Energetyki Cieplnej S.A. of Bielsk Podlaski to the gas

network; the customer has declared to accept 15,000 thousand cubic metres of gas fuel p.a. (following modernisation of the town's central boiler house);
- Distribution network roll-out in the Prażmów municipality. The project involves construction of gas pipelines with a total length of ca. 31 km and 1,545 gas connections.

The company also executed projects of local network roll-out using the LNG technology: provision of access to gas supplies in Mieroszów and Suwałki, with switch-over of customers from propane-butane-air to natural gas supplied from PGNiG S.A.'s LNG regasification stations in Olecko and Ełk. In 2014, gas from the newly launched LNG regasification station in Suwałki was injected to a new gas network with a length of over 25 km. A total of 17 thousand customers were switched over to natural gas.

The tables below present the segment's key operating data.

	2014		2013
	MWh	mcm*	mcm*
Volume of gas transmitted via the distribution system	102,858	9,327	9,849
- high-methane gas	95,027	8,610	9,054
- nitrogen-rich gas	4,991	458	478
- propane-butane-air and decompressed propane-butane	16	2	1
- coal gas	2,824	257	316

*mcm measured as high-methane gas equivalent

	Unit of measure	2014	2013
Length of network, excl. connections**	km	124,606	122,691
No. of customers	million shares	6.8	6.8
No. of new customers connected to the network	('000)	80	71

**Own and third-party networks.

2. Planned activities

In 2015, Polska Spółka Gazownictwa Sp. z o.o. will mainly continue working on projects for which EU co-financing agreements have been signed and projects financed with its own funds.

In the following years, the company will focus on:
- New customer connections and infrastructure extension
- Network upgrade
- Implementation of integrated IT systems.

Infrastructure extension to enable new connections is a vital factor in the Company's operations. In some areas, upfront investments are needed to eliminate certain infrastructure inadequacies before new customers can be connected to the network, particularly in the Provinces of Warsaw, Białystok and Łódź, where the company plans its major capacity expansion projects. Plans are also in place to extend the distribution network into unserved areas.

The majority of the company's network assets are over 40 years old. The degree of physical obsolescence is a particular issue in the case of key sections of the high-pressure gas network, which should be in good technical condition as it enables the supply of gas to large areas of the country. Therefore, the company plans to increase the share of upgrade projects in its CAPEX budget.

Furthermore, steps are being taken to extend the functionality of the existing gas infrastructure to enable transmission of other gases, notably hydrogen; these steps pertain to both technical and regulatory issues. After this gas network upgrade is completed, the company will be able to launch new services and connect new customers from the power generation, automotive and other industrial sectors where hydrogen is used in production processes.

The implementation of integrated IT systems will facilitate the management of the company's nationwide operations. Changes to the rules governing the European gas market necessitate investment in systems for automated network balancing, settlement of distributed gas volumes and change of gas suppliers.

3. Risks related to distribution

Legislation

The complex provisions of the Building Law and regulations governing construction projects impose the obligation to prepare extensive project and legal documentation, which is an integral part of any investment process. The need to prepare such documentation protracts the time needed for project preparation and thus may significantly delay its completion, exposing the company to the risk of cost overruns caused by potential delays in contract performance, as well as to the risk of lower revenues.

Tariff policy

By setting tariffs, the President of the Energy Regulatory Office, citing social considerations, limits the growth of regulated revenue, which is the basis for calculation of charge rates. This prevents the company from enjoying the full return on capital employed. Furthermore, the protracting tariff approval proceedings result in tariffs becoming effective later than requested by PGNiG, leading to lower revenue from the provision of distribution services.

Direct competition

Liberalisation of the gas market is contributing to intensified competition in the segment. Companies distributing natural gas are progressively expanding their gas networks and attracting new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are significantly lower here, as LNG distribution involves much lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the segment's competitive position is the tariff policy of the Energy Regulatory Office, which makes it difficult for the PGNiG Group to operate a flexible pricing policy for some groups of customers. With the lack of flexible pricing, competitors' offers may prove to be an attractive alternative to the PGNiG Group's customers. However, the risk of Polska Spółka Gazownictwa Sp. z o.o. losing its dominant market position is low.

Claims raised by property owners

More and more frequently, the PGNiG Group is facing excessive financial claims raised by owners of land plots where the gas network was developed in the past. Transmission easement serves as a basis for determining the extent of the use of third-party property by a transmission company, for which relevant consideration is due to the owner. The owners' claims give rise to additional, frequently considerable costs, and thus may adversely affect the financial performance of the segment.

Sources of gas supply for the distribution system

Polska Spółka Gazownictwa Sp. z o.o.'s distribution network is connected to the transmission system operated by OGP GAZ-SYSTEM S.A., which is its main source of gas supplies. The transmission system's limited capacity in terms of the volume and pressure of supplied gas hinders or sometimes renders impossible further development of the gas grid within the company's key areas of operation.

Section X: Generation

The segment’s principal business activity is the generation of heat and electricity. The segment’s business also includes execution of major natural gas-fired projects in the power sector.

PGNiG TERMIKA S.A. is involved in the generation, distribution and sale of heat and electricity. The company also serves as the Group’s competence centre for heat and electricity generation and execution of heat and power projects. The company’s main revenue sources are sales of heat, electricity, system services, and certificates of energy origin. The installed capacity of the company’s generating assets is 4.8 GW of achieved thermal power and 1 GW of achieved electrical power, which satisfies approximately 70% of the heat demand on the Warsaw metropolitan market. PGNiG TERMIKA S.A. is also a producer and supplier of heat and the owner of heat sources and heat networks in Pruszków, Komorów and Piastów, as well as the owner of a 7 MW gas-fired heating plant and a distribution network supplying heat to the Regaty residential estate in the Warsaw district of Białołęka.

1. Segment’s operations

As at December 31st 2014, PGNiG TERMIKA S.A. held an electricity trading licence valid until December 31st 2030, as well as the following licences, each valid until December 31st 2025:
- for production of heat
- for transmission and distribution of heat
- for production of electricity.

Tariffs

The former tariff applicable to PGNiG TERMIKA S.A.’s sales of heat generated at the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola Heating Plant and Kawęczyn Heating Plant, and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant, was effective until July 31st 2014. On July 8th 2014, the President of the Energy Regulatory Office approved a new tariff, effective from August 1st 2014.

Until December 31st 2014, the company was required to apply the following tariffs for the transmission of heat through the heating network in the following areas:
- Marsa Park – tariff approved on May 17th 2013,
- Annopol – tariff approved on May 17th 2013,
- Marynarska – tariff approved on August 13th 2013,
- Chełmżyńska – tariff approved on May 17th 2013,
- Jana Kazimierza – tariff approved on August 13th 2013.

Until April 30th 2015, the company is also required to apply the tariff for the production of heat at the Regaty heating plant and transmission of heat through the heating network in the Regaty residential estate − tariff approved on January 8th 2014.

On November 18th 2014, the President of the Energy Regulatory Office approved new heat transmission tariffs for the following areas: Marsa Park, Annopol, Marynarska, Chełmżyńska and Jana Kazimierza. The new tariffs will be in effect from January 1st 2015 to July 31st 2016.

Production

PGNiG TERMIKA S.A.'s key products are heat and electricity. In 2014, 100% of total electricity output was electricity cogenerated with heat. The table below presents PGNiG TERMIKA S.A.'s production volumes.

Electricity and heat production volumes

Product	Unit of measure	2014	2013
Electricity	GWh	4,173	4,436
Heat	TJ	36,923	40,540

The company also provided Network Constrained Generation services under an agreement with PSE Operator S.A., pursuant to which the company maintains a long-term plant margin and keeps a specific number of generating units available, so as to overcome limitations in the operation of power sources in the national power system and to ensure Warsaw's energy security. PGNiG TERMIKA S.A. is required to generate electricity whenever so instructed by the Transmission System Operator. In performance of the agreement, by December 31st 2014 the company had generated 199 GWh of electricity.

Sales

In 2014, PGNiG TERMIKA S.A. sold 36,617 TJ of heat. PGNiG TERMIKA S.A. sold heat mainly to Dalkia Warszawa S.A., which purchased 94.6% of the heat generated by the company. In 2014, Dalkia Warszawa S.A. contracted 3.6 GW of PGNiG TERMIKA's heat generation capacity. The balance of the produced heat was sold to local customers, mainly in Pruszków and the surrounding areas.

In 2014, PGNiG TERMIKA SA sold a total of 3,555 GWh of electricity generated at its plants. The key customer for electricity generated at PGNiG TERMIKA S.A.'s plants was PGNiG S.A., with an aggregate share in the company's electricity sales volume in 2014 reaching 99%. The company also sold electricity to smaller customers.

Construction of a CCGT unit in Stalowa Wola

In 2014, key components were delivered and installation of the steam and gas turbines began on site of the 'Construction of a CCGT Unit in Stalowa Wola', project, pursued in partnership with Tauron Polska Energia S.A. Some of the auxiliary equipment was installed, including pumps, exchangers, ejectors, and turbine lubrication systems. In the period under review, the acceptance of stage I work on the San river weir took place, and work on stage II of the project commenced.

2. Planned activities

The objectives PGNiG TERMIKA SA wants to pursue on its existing markets in 2015 is to expand its heat distribution network and increase heat sales volumes.

In 2015, management of the electricity portfolio and commercial balancing for PGNiG TERMIKA S.A. will be performed through PGNiG Energia S.A., which enters into dated power purchase contracts on the Commodity Derivatives Market. In addition, PGNiG S.A. will be the key customer for electricity generated at PGNiG TERMIKA S.A.'s plants.

In the following years, PGNiG TERMIKA SA plans to scale up its power and heat generation operations in the Warsaw area and beyond. Projects will be implemented independently or with business partners. The company intends to focus on projects based on gas-fired or biomass-fired generation sources, to gradually reduce its coal consumption and increase the share of low- and zero-emission fuels in its energy mix.

April 30th 2014 saw entry into force of the amended Energy Law, which reintroduced the support system for electricity cogeneration by reinstating the obligation to hold and redeem red certificates (23.2% of the portfolio of electricity supplied to end users) and yellow certificates until the end of 2018. Certificates are issued for generation of electricity using high-efficiency co-generation technology. Proceeds from the sale of certificates of origin will add to the revenue of PGNiG TERMIKA S.A., which will be able to use the extra funds to continue the upgrade of its existing assets. This will increase the efficiency of cogeneration, which in turn will improve the competitiveness of PGNiG TERMIKA S.A.

On September 5th 2014, a new Act Amending the Environmental Protection Law and Certain Other Acts came into force. PGNiG TERMIKA SA is at an advanced stage of work on adjusting its existing assets to the tighter environmental standards. At the Siekierki CHP Plant a desulfurisation and nitrogen rejection systems were installed, and at the Żerań CHP Plant a CCGT unit and a new gas- and oil-fired boiler house are to be built. Also, the Wola Heating Plant will be converted to light oil combustion, generating lower quantities of noxious substances, while the Kawęczyn Heating Plant will begin to use high-quality grade of coal with a sulfur content of less than 0.4%.

3. Generation risks

More stringent gas and dust emission standards

In order to meet the more stringent gas and dust emission standards expected to be effective as of 2016, producers will have to thoroughly modernise their power and CHP plants and may be forced to shut down a number of generating units (to a total capacity 4,000-6,000 MWe by 2020) where installation of expensive flue gas treatment systems is not economically viable.

Maintaining share in the municipal heat market

Following expansion of the Warsaw municipal waste incineration plant, the quantity of heat supplied to the city’s municipal network will increase. As a result, PGNiG TERMIKA S.A.’s share in total heat supplies to the Warsaw municipal network will fall from the current 98%, to 95% in 2019.

Marketing efforts conducted jointly with Dalkia Warszawa S.A., and connecting further western districts of Warsaw to the municipal heating network should significantly reduce potential future decline in the volume of energy produced at PGNiG TERMIKA S.A.’s generating plants. To maintain its share in the municipal heat market, the company will also offer “green” heat generated at biomass-fired units, and will continue to sell energy at competitive prices and take advantage of the TPA rule to gain access to new end users.

Section XI: Other Activities

1. Segment's operations

In 2014, the segment's companies conducted work involving: construction and assembly of gas transmission pipelines, gas compressor stations, and distribution and metering nodes, as well as construction and expansion of underground gas storage facilities, and development of hydrocarbon deposits. They were also involved in design of systems, including gas transport systems, and provision of hotel, restaurant and spa centre services.

The services offered by the segment were provided to both third-party customers and PGNiG Group companies. The key projects executed in 2014 included construction and assembly of high-pressure gas pipelines, gas distribution and metering nodes and gas compressor stations, development of natural gas deposits, as well as production of drilling equipment and spare parts for drilling rigs and drillships.

The key projects executed for third-party customers included:

- Construction of the 175.2 km DN 700 high-pressure gas pipeline from Gustorzyn to Rembelszczyzna, for OGP GAZ-SYSTEM S.A.,
- Construction of a 20.1 km section of the DN 700 high-pressure gas pipeline from Trojane to Vodice, for Plinovodi d.o.o. (Slovenia),
- Construction of a 64 km section of the DN 700 high-pressure gas pipeline from Szczecin to Gdańsk (stage I: Płoty–Karlino section) for OGP GAZ-SYSTEM S.A.,
- Construction of the Jeleniów II Gas Compressor Station for OGP GAZ-SYSTEM S.A.,
- Upgrade of the Hermanowice distribution and metering node for OGP GAZ-SYSTEM S.A.,
- Development of the Komorze natural gas field for FX Energy Poland Sp. z o.o., the project has been completed,
- Production of drilling rig and drillship equipment parts for MHWirth AS (formerly Aker Solutions, Norway),
- Assembly of HDPE pipelines, valves and hydrants under the Polish LNG Project for Saipem S.P.A. S.A. Polish Branch.

In addition, work performed by the segment's companies for third-party customers included: preparation of design documents and author's supervision of investment projects related to the construction of the oil terminal in Gdańsk, production of well equipment (production and injection wellheads), as well as provision of hotel, restaurant and spa centre services.

Work executed by the segment for PGNiG S.A. included the following construction and assembly contracts:

- Construction of the water-injection system for the BMB (Barnówko – Mostno – Buszewo) field,
- Development of gas wells at the Łapanów and Krasne gas production facilities,
- Changes in the configuration of gas compressors for the Wierzchowice underground gas storage facility (reversible operation of gas compressors),
- Completion of construction of the Wierzchowice underground gas storage facility (a project previously performed by PBG),
- Extension of the Brzeźnica underground gas storage facility,
- Development of the Połęcko field.

The segment's work for PGNiG S.A. also included continued assembly of a new compressor at the Husów underground gas storage facility, manufacture of well equipment, such as casing heads and production wellheads, as well as completion of the modernisation project on a gas compressor station in Żuchlów.

The most important contracts executed for other PGNiG Group companies included:

- Installation of four nodes and ten block/bleed systems for the DN 700 high-pressure gas pipeline from Gustorzyn to Odolanów,
- Construction work on the 23.9 km DN 300 high-pressure gas pipeline from Rybno to Młynowo,
- Extension of the Mogilno underground gas storage cavern facility.

In addition, the segment's work for other PGNiG Group companies included preparation of gas infrastructure technical and design documents, as well as provision of technical and expert consulting services.

2. Planned activities

In 2015, the segment will continue construction and assembly work related to the construction of gas pipelines and gas infrastructure, as well as development of oil and gas assets and extension of underground gas storage facilities. The segment's companies intend to maintain their market positions in the manufacturing of equipment, including well surface equipment for conventional and unconventional deposits, drilling platforms, equipment for oil and gas production facilities, and gas system design.

3. Risks related to other activities

Legislation

Administrative regulations and procedures on the preparation of investment projects and obtaining building permits, including in particular regulations governing compliance with environmental requirements, may significantly delay project execution and expose the segment to the risk of cost overruns caused by potential delays in contract performance, and to the risk of lower revenue. The Public Procurement Law and other regulations which stipulate contract price as the only criterion in bid evaluation cause the segment's companies to lose out to competitors offering lower prices for inferior quality services.

Competition

The operations of companies offering construction and assembly services, design services, as well as manufacturers of drilling equipment, are significantly exposed to growing competition from foreign companies, both those operating in their local markets abroad and those entering the Polish market, and from Polish market players. Given the current level of investment in the segment's area of operations, the growing competition results in a continued downward pressure on prices for the services offered by the segment companies. As far as designing of gas transmission installations is concerned, acquisition of medium-sized design companies by large contractors and setting up of new design units within gas industry operators are unfavourable phenomena which adversely affect the segment companies' ability to form consortia with project execution companies and secure new orders. Another major risk in this area is the growing competition from new business groups and international engineering corporations.

Qualified personnel

Increasing competition from local and foreign companies on the Polish market has intensified the process of highly qualified employees with extensive professional experience leaving and taking up employment with the competitors.

Section XII: Investments

In 2014, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 3,827m, having gone up by ca. 15% year on year. The table below presents the Group's expenditure in the individual segments.

Capital expenditure (PLNm)

	2014	2013
Exploration and Production	1,956	1,446
Trade and Storage	335	472
Distribution	1,120	1,139
Generation	410	257
Other Activities	6	12
Total	3,827	3,326

Below are described the key capex projects implemented by the PGNiG Group in 2014.

<u>Exploration and Production</u>

The capital expenditure incurred in 2014 in the Exploration and Production Segment amounted to PLN 1,956m.

The expenditure of PGNiG S.A. on exploration work amounted to PLN 451m. It included chiefly the cost of geophysical surveys, six wells drilled with positive results, and wells on which work is still under way.

In 2014, the PGNiG Group's expenditure on gas & oil exploration and production work on the Norwegian Continental Shelf amounted to PLN 949m. It included mainly the cost incurred to acquire interests in four fields located on the Norwegian Continental Shelf. The interests cover six licences in three producing fields (Morvin, Vilje and Vale) and one field in the development phase (Gina Krog). Other expenditure was related to the development of the Gina Krog and Snadd fields, preparation of the Skarv field for the second stage of drilling, and exploration projects.

The segment's other investment projects involved the development of documented gas reserves (including already producing fields), projects executed to sustain or restore hydrocarbon production rates, and projects for the operation of the hydrocarbon production area. The key investment projects included:

- Completion of development of the Lisewo and Komorze gas fields,
- Completion of development of a well in the Radlin field,
- Completion of development of the Maćkowice-3K well,
- Completion of drilling work and commencement of development of a well in the Daszewo field,
- Drilling work and development of wells in the Brońsko field,
- Drilling work and development of wells in the Przemyśl field,
- Development of the Księżpol 19 well.

Trade and Storage

The capex of the Trade and Storage segment amounted to PLN 335m. Major investment projects in 2014 included construction and extension of underground gas storage facilities, including:

- Wierzchowice underground gas storage facility − removal of defects in the power section (the turboexpander),
- Kosakowo underground gas storage cavern facility − in December 2014, following final acceptance, two caverns (K-2 and K-3) started to be filled with gas. Moreover, construction of the K-5 cavern was continued and 5 more holes were drilled for construction of new caverns,
- Mogilno underground gas storage cavern facility − the Z-15 cavern started to be filled with gas; gas also started to be pumped into the Z-17 cavern, while construction of the Z-16 cavern was continued,
- Husów underground gas storage facility − extension of the storage facility to bring its capacity up to 500 mcm was completed in December 2014 − the facility started to be filled with gas; total expenditure on the project amounted to PLN 64m.

On April 2nd 2014, PGNiG S.A. terminated its contract with the consortium contracted to carry out construction work at the Wierzchowice underground gas storage facility, comprising PBG S.A. w upadłości układowej (in company voluntary arrangement), Tecnimont S.p.A., Société Française d'Etudes et de Réalisation Equipements Gazier SOFREGAZ, Plynostav Pardubice Holding A.S. and Plynostav – Regulace Plynu A.S. in organisational bankruptcy. The grounds for the termination were improper performance of the project in conflict with the contract, as well as a delay in execution of work exceeding 30 business days, which continued unrectified even though the consortium had been given an extended deadline to remove the default. The work related to the power section (the turboexpander) of the Wierzchowice underground gas storage facility will be completed by PGNiG Technologie S.A.

In 2014, PGNiG S.A. completed a project consisting in LNG-based distribution of gas fuel to customers in Ełk and Olecko. This project was a part of an initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (PESO project), and involved construction of an LNG regasification station and two-step pressure reduction, metering and odorising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas. Total expenditure on the project amounted to PLN 12m.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 1,120m. The capex budget was spent on upgrading and extending the gas network and on connecting new customers. For a discussion of key projects in the Distribution segment, see Section VIII Distribution.

Generation

Starting from 2016, Poland will be subject to more stringent standards of gas and dust emission, for which reason the modernisation of power plants and CHP plants is necessary. In order to meet the more stringent emission requirements, PGNiG TERMIKA S.A. has gradually been modernising its generating assets. Capital expenditure of the Generation segment amounted to PLN 410m, of which approximately PLN 50m was spent on environmental protection projects. Furthermore, in 2014 the segment continued some of the investment projects commenced in previous years. The most important of these were:

- Construction of a 450 MW CCGT unit at the Żerań CHP plant; in 2014 the construction design of the CCGT unit and gas pipeline was completed, a building permit was obtained for construction of a water discharge pipeline and modernisation of the cooling water system, and the site was prepared for construction,

- Conversion of the K1 boiler at the Siekierki CHP plant into a biomass-fuelled unit; in 2014, the construction design was completed, a building permit was obtained, and the following works were completed: construction work related to dismantling of the boiler's auxiliary equipment, assembly of pressurised section, replacement of a superheater, and laying the foundations for selected buildings,
- Reconstruction of the Pruszków CHP plant; in 2014 − commencement of works related to construction of a water treatment station,
- Construction of a gas- and oil-fired peak-load and reserve boiler house at the Żerań CHP plant; in 2014, the tender procedure was cancelled (as all bids exceeded the planned budget), and the tender documentation was updated.

In addition, the segment continued upgrading projects on:

- Dust collectors of fluidised bed boilers at the Żerań CHP plant,
- K8 and K9 boilers at the Siekierki CHP plant,
- K2, K3 and K4 boilers at the Wola Heating plant.

Other Activities

In 2014, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 6m. Major investment projects included purchase of production plant and equipment, software, buildings and structures, and vehicles.

Section XIII: Environmental protection

Well and extraction pit abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to properly abandon worked-out extraction pits, eliminate the danger and repair any damage caused by mineral extraction, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and into water courses. Furthermore, if gas wells remain unplugged, there is a risk that escaping gas could accumulate, posing a fire hazard. In 2014, plug and abandonment operations were performed on a total of 45 wells and 34 extraction pits.

Carbon credit trading system

In 2014, PGNiG TERMIKA S.A. (the Siekierki, Żerań and Pruszków CHP plants and the Kawęczyn and Wola heating plants), the Zielona Góra Branch and the Odolanów Branch, the Mogilno Underground Gas Storage Cavern Facility, the LMG Oil and Gas Production Facility, the Wierzchowice Underground Gas Storage Facility and the Kosakowo Underground Gas Storage Cavern Facility were covered by the carbon dioxide emission trading scheme (ETS). In 2014, emissions from these installations were 5,789,032 Mg CO_2. In 2014, the PGNiG Group reviewed annual reports on its carbon dioxide emissions for 2013. Carbon emissions from the Group's installations covered by the EU ETS scheme totalled 6,111,102 Mg. After reconciling its CO_2 emissions with emission rights held, and after redeeming the allowances allocated for 2013, a deficit of 2,054,830 Mg CO_2 free emission units was identified. The deficit was covered with reserves accumulated in the accounts of the Group installations (unused free allocations from previous years) and with allowances purchased on the Intercontinental Exchange Futures Europe.

In the current trading period (2013-2020), the free allocation of CO_2 emission allowances covers only a part of the actual emissions. The free allocations will decrease gradually, reaching zero in 2027.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG S.A. conducts diagnostic tests, surveys and land reclamation work in areas polluted in the course of past activities, with a view to restoring them to the condition required under the environmental quality standards. In 2014, work was completed on a real property located in Warsaw using an *in-situ* bioremediation method. Through the application of a biopreparation made on the Company's instruction from indigenous microorganisms, within two years the soil was cleaned up to a standard typical of service/industrial areas. The Company also monitored the soil-water environment of the reclaimed landfill site and a property in Zabrze.

REACH and CLP

In 2014, PGNiG S.A. was supervising the compliance by its subcontractors using chemical substances for well treatments with the regulations of the European Parliament and of the Council of the European Union on safe use of chemicals (*REACH*) and on the classification, labelling and packaging of substances and mixtures (*CLP*). The Company also drew up contractual provisions, to be included in its hydraulic fracturing, mud and cementing service agreements, concerning the use of chemical substances and mixtures, which would facilitate the control of related hazards and ensure compliance with all requirements imposed by Polish and EU laws. At the request of the Polish Exploration and Production Industry Organization, the Company also compiled a list of all substances and mixtures it had used for fracturing operations.

Environmental protection in drilling operations

Drilling work performed as part of exploration for and production of hydrocarbons has an impact on the environment in the immediate vicinity of the site where it is carried out (the affected area for one borehole is approximately one hectare). Drilling operations cause a temporary change in the character of the land, increased emissions of gases and exhaust fumes, higher noise intensity and generation of waste.

In order to protect the land surface, the upper layer of soil is stripped off to be used later for land reclamation. A drilling rig is installed on tightly insulated ground. Diesel oil tanks and receptacles for waste and hazardous substances are stored in special containers. Drilling muds are prepared with chemical substances and mixtures meeting the requirements of the EU and Polish law. Besides water (about 25%), organic components (polymers) are the largest mud additives by weight. All waste generated in connection with borehole drilling or human presence on the drilling site is collected in tightly-sealed vessels and transferred to authorised waste management operators.

Emissions of gases and exhaust fumes into the atmosphere are limited by maintaining the drilling rig engines in excellent operating condition and using quality fuel to run the engines. Repeated surveys of the quality and quantity of pollutant emissions into the air and of their distribution patterns have shown that all air pollutant concentration standards are met in the areas where drilling work is conducted.

Noise intensity is reduced by using machinery and equipment that produce less noise, and if the noise emission standards are exceeded, means of acoustic protection are used, such as screens installed to shelter the pipe ramp and pipe rack on drilling rigs.

Special devices are used to minimise the volume of drilling waste, for instance through drilling mud recycling (screens on shale shakers, centrifuges, desilters and desanders). On the other hand, the volume of waste generated in connection with the operation of drilling equipment is limited through the use of modern long-life engine, gear and lubricating oils. Application of the highest quality fuels in latest generation power generators protects filters against excessive fouling, which prolongs their useful lives. End-of-life filters are hazardous waste. Waste generated on a drilling site is stored in a manner ensuring protection of the environment and of human health. Stored waste is pre-segregated. All waste storage sites are appropriately marked and under constant surveillance.

In 2014, expenditure incurred by Exalo Drilling S.A. on projects aimed at limiting the impact of its drilling operations on the environment amounted to approximately PLN 17m. The funds were spent mainly on projects designed to reduce the volume of drilling waste and limit emissions into the environment, for instance by providing drilling rigs with modern power generators, fuel tanks, shale shakers, mud tanks and waste receptacles, and putting in place a mobile evaporator system enabling waste neutralisation. By equipping its drilling rigs with modern equipment, the PGNiG Group is able to meet the applicable technical and environmental standards.

Reclamation of the fuel ash landfill site

PGNiG TERMIKA S.A. is carrying out reclamation of the Myśliborska fuel ash landfill site for the Żerań CHP plant. The project will involve reclamation of the land as green areas (Cells No. 1 and 2) and for residential and commercial development (Cell No. 3). In 2014, the company completed technical reclamation of Cell No. 2 and transport of soil to fill Cell No. 3. Work was carried out on dismantling the technical infrastructure between the Żerań CHP plant and the landfill site, and macrolevelling and soil compaction commenced in Cell No. 3. The full scope of the reclamation work is scheduled for completion in 2016.

Fulfilment of the requirements of the Industrial Emissions Directive

In 2014, in an effort to meet the environmental standards provided for in Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (IED), PGNiG TERMIKA S.A. accounted for the project it completed in 2013 involving construction of NOx selective catalytic reduction (SCR) units for four unit boilers at the Siekierki CHP Plant. Capital expenditure on the project amounted to PLN 180m, of which PLN 52m came from the Infrastructure and Environment Operational Programme of the National Environmental Protection and Water Management Fund. Thanks to this project, annual NO_x emissions from the boilers' SCR units will be reduced by 70%, i.e. 2 thousand tonnes of NO_x per year.

Moreover, the company embarked on new projects aimed at reducing the emissions of gases and particulate matter into the atmosphere, i.e.:

- Conversion of coal-fired boiler No. 1 at the Siekierki CHP plant into a biomass-fired unit; the converted boiler is to be placed in service late in 2015; the expected annual reduction of pollutants into the atmosphere comprises: reduction of CO_2 emissions by 227,000 tonnes, SO_2 emissions − by 780 tonnes, NO_x emissions − by 260 tonnes and particulate matter emissions −by 20 tonnes;
- Provision of the fluidised bed boilers at the Żerań CHP plant with high efficiency dust collectors (bag filters) and thus enhancing the desulfurisation process; the project is scheduled for completion late in 2015;
- Conversion of mazout-fired water boilers at the Siekierki CHP plant and the Wola Heating Plant into light oil units, including modernisation of their burners; the project is scheduled for completion by the end of 2015.

Noise reduction project at the Siekierki CHP plant

In 2014, noise barrier walls around coal unloading points located at the hump tracks on the plant's premises were completed. As part of the same project, noise barrier walls were constructed along the eastern boundary of the CHP plant in 2013. The purpose of the project was to reduce the risk of exceeding the permitted noise levels during the execution of future projects at the Siekierki CHP plant. Expenditure on this project amounted to approximately PLN 4m.

Biomass supplies

In order to fulfil the requirements of Directive 2009/28/EC on the promotion of the use of energy from renewable sources and use of biomass other than forest biomass, that is biomass from plantations and energy plant crops at commercial power plants (Regulation of the Minister of Economy dated October 18th 2012), PGNiG TERMIKA S.A. procures the fuel under long-term contracts for the supply of biomass from energy willow plantations. Currently, the company procures biomass from plantations with a total area of ca. 386 ha. Thanks to the use of biomass as a fuel, CO_2 emissions were reduced by 59,862 Mg in 2014.

Section XIV: Other information

Distribution of the 2013 profit

On May 15th 2014, the Annual General Meeting of PGNiG S.A. passed a resolution on the distribution of the 2013 net profit of PLN 1,688.6m. The profit was distributed as follows:
- PLN 797.0m was allocated to the Company's statutory reserve funds,
- PLN 885.0m was allocated for dividend payments (dividend per share of PLN 0.15),
- PLN 6.6m was allocated to cover accumulated losses taken over by PGNiG S.A. on merger with PGNiG Energia S.A.

The Annual General Meeting of PGNiG S.A. set August 14th 2014 as the dividend record date and September 4th 2014 as the dividend payment date.

Discharge granted to Management Board and Supervisory Board members in respect of their duties

On May 15th 2014, the Annual General Meeting of PGNiG S.A. approved the financial statements and the Directors' Report on the operations of PGNiG S.A., as well as the consolidated financial statements and the Directors' Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG S.A. in respect of their duties in the financial year 2013.

Agreement on the establishment of the PGNiG tax group

The PGNiG tax group, set up for the purpose of accounting for corporate income tax, was registered on February 24th 2014, and commenced operations on April 1st 2014. The PGNiG tax group comprises the following companies: PGNiG S.A., PGNiG Obrót Detaliczny Sp. z o.o., Polska Spółka Gazownictwa Sp. z o.o., PGNiG TERMIKA S.A., Operator Systemu Magazynowania Sp. z o.o., PGNiG SPV 5 Sp. z o.o., PGNiG SPV 6 Sp. z o.o. and PGNiG SPV 7 Sp. z o.o. The PGNiG tax group agreement covers three consecutive tax years, i.e.:
- from April 1st 2014 to December 31st 2014,
- from January 1st 2015 to December 31st 2015,
- from January 1st 2016 to December 31st 2016.

Other PGNiG Group companies are separate corporate income taxpayers.

Proceedings before the President of the Polish Office of Competition and Consumer Protection (UOKiK)

On December 28th 2010, the President of the Polish Office of Competition and Consumer Protection ("UOKiK") instigated, ex officio, anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interests of other business players or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In its decision of July 5th 2012, the President of UOKiK found these practices to be anti-competitive, concluded that PGNiG S.A. had discontinued those practices as of November 30th 2010, and imposed on the Company a fine of PLN 60,016,474.40. On July 24th 2012, PGNiG S.A. filed an appeal against the decision of the President of the UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. In the judgement of May 12th 2014, the Regional Court of Warsaw dismissed PGNiG's appeal. On June 4th 2014, PGNiG S.A. appealed against the decision to the Warsaw Court of Appeals. As at the date of this report, the Warsaw Court of Appeals had not notified PGNiG S.A. of a hearing date.

On February 22nd 2013, the President of UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of UOKiK accused PGNiG S.A. of using provisions classified as abusive clauses in contract forms based on which comprehensive gas fuel supply contracts are concluded. PGNiG S.A. voluntarily agreed to revise the above contract forms with respect to the questioned clauses. By virtue of a decision of June 28th 2013, the President of the UOKiK resolved not to impose a fine on PGNiG S.A. and obligated the Company to fulfil its commitment. On July 29th 2014, PGNiG S.A. notified the President of the UOKiK that it had fully complied with the obligation imposed on it by virtue of the above decision.

On April 3rd 2013, the President of UOKiK instigated anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- limiting the ability of business customers to reduce ordered volumes of gas fuel and contractual capacity,
- limiting the ability of business customers to resell gas fuel,
- requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain provisions in contracts with its non-household customers. By virtue of a decision of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG S.A. complied with the obligations imposed by the decision of the President of UOKiK within the prescribed time limits. On August 1st 2014, PGNiG Obrót Detaliczny Sp. z o.o. took over the gas retail business from PGNiG S.A. and consequently assumed all rights and obligations under the decisions issued by the President of UOKiK on the basis of the Act on Competition and Consumer Protection to the extent they related to agreements to which PGNiG Obrót Detaliczny Sp. z o.o. became a party. PGNiG Obrót Detaliczny Sp. z o.o. is in the course of performing the obligation (to the extent corresponding to its scope of business) imposed under the decision of the President of UOKiK dated December 31st 2013.

On October 17th 2014, the President of UOKiK commenced administrative proceedings to impose a fine under Art. 107 of the Act on Competition and Consumer Protection of February 16th 2007 (consolidated text in Dz.U. of 2015, item 184) on PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. on suspicion of a delay in compliance with Section I).4) of the conclusion of the President of UOKiK's decision of December 31st 2013. On the same date, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. were requested to provide explanation within 21 days. In their response, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. presented grounds for their actions and their position whereunder such actions comply with Section I).4) of the conclusion of the President of UOKiK's decision of December 31st 2013. By the date of this report, the President of UOKiK had not issued any final ruling on the case.

Collective dispute with the employer

On October 21st 2014, an agreement was executed ending the collective dispute between the trade unions active at PGNiG S.A. and the Management Board of PGNiG S.A. The collective dispute was initiated on July 9th 2014 after the Company's Management Board decided not to grant the demands put forward by the PGNiG trade unions, which concerned setting the remuneration growth rate for 2014 at 5.59% per year, increasing the value of vouchers to PLN 2,000 per year, and revoking the termination of Agreements on Annual Bonus of March 27th 2013 and June 24th 2013. In the agreement that was reached, the parties decided, among other things, to waive the remuneration growth in 2014, limit the value of vouchers distributed to employees in 2014 to PLN 1,500 and recognise the termination of Agreements on Annual Bonus of March 27th 2013 and June 24th 2013 as effective.

Proceedings with a value in excess of 10% of the Company’s equity

In 2014, neither PGNiG S.A. nor its subsidiaries were engaged in any proceedings before a court, arbitration tribunal or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of the Company’s equity.

Section XV: Financial performance

1. Financial performance in 2014

The separate financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group for 2014 are audited by PKF Consult Sp. z o.o. The agreement with the auditor was signed on February 5th 2013, for three years (2013-2015). Detailed information on the auditor's fees is provided in the consolidated financial statements of the PGNiG Group for 2014 (Note 36.6).

1.1. Key financial and business data

The consolidated financial statements of the PGNiG Group have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union as at December 31st 2014. The accounting policies applied in preparing the financial statements are presented in the consolidated financial statements of the PGNiG Group for 2014 (Note 2).

In 2014, the PGNiG Group posted a net profit of PLN 2,822m, up by PLN 902m year on year.

Summary information on the PGNiG Group's financial standing in 2014 relative to 2013 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- statement of financial position,
- statement of profit or loss,
- statement of cash flows,
- selected financial ratios.

Consolidated statement of financial position (PLNm)

ASSETS	Dec 31 2014	Dec 31 2013	Jan 1 2013
Total non-current assets	37,692	37,479	38,343
Property, plant and equipment	33,528	33,033	33,784
Investment property	9	9	11
Intangible assets	1,113	1,164	1,146
Investments in equity-accounted associates	856	727	771
Other financial assets	243	242	172
Deferred tax assets	1,783	2,233	2,383
Other non-current assets	160	71	76
Total current assets	11,234	10,905	10,833
Inventories	3,189	3,378	3,064
Trade and other receivables	4,236	4,086	5,374
Current tax assets	5	48	150
Other assets	132	171	84
Derivative financial instrument assets	567	307	105
Cash and cash equivalents	2,958	2,827	1,948
Assets held for sale	147	88	108
Total assets	48,926	48,384	49,176

Consolidated statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Dec 31 2014	Dec 31 2013	Jan 1 2013
Total equity	30,169	28,453	27,197
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	(270)	(49)	(152)
Retained earnings	22,794	20,856	19,705
Equity attributable to owners of the parent	30,164	28,447	27,193
Equity attributable to non-controlling interests	5	6	4
Total non-current liabilities	12,384	12,093	12,366
Borrowings and other debt instruments	5,069	5,385	5,509
Employee benefit obligations	604	502	381
Provisions	1,803	1,405	1,792
Deferred revenue	1,581	1,533	1,448
Deferred tax liabilities	3,250	3,210	3,183
Other non-current liabilities	77	58	53
Total current liabilities	6,373	7,838	9,613
Trade and other payables	3,589	4,033	3,667
Borrowings and other debt instruments	769	2,276	4,702
Derivative financial instrument liabilities	593	124	393
Current tax liabilities	191	184	24
Employee benefit obligations	284	375	356
Provisions	720	645	350
Deferred revenue	227	186	101
Liabilities associated with assets held for sale	-	15	20
Total liabilities	18,757	19,931	21,979
Total liabilities and equity	48,926	48,384	49,176

Consolidated income statement (PLNm)

	2014	2013
Revenue	34,304	32,044
Total operating expenses	(30,461)	(28,895)
Raw materials and consumables used	(21,229)	(19,873)
Employee benefits	(2,827)	(3,214)
Depreciation and amortisation	(2,502)	(2,463)
Services	(2,843)	(2,808)
Work performed by the entity and capitalised	980	983
Other income and expenses	0(2,040)	(1,520)
Operating profit	3,843	3,149
Finance income	86	69
Finance costs	(432)	(465)
Share in net profit/(loss) of equity-accounted entities	129	(44)
Profit before tax	3,626	2,709
Income tax	(804)	(789)
Net profit	2,822	1,920
Attributable to:		
Owners of the parent	2,823	1,918
Non-controlling interests	(1)	2
	2,822	1,920
Earnings and diluted earnings per share attributable to holders of ordinary shares of the parent (in PLN)	0.48	0.33

Consolidated statement of cash flows (PLNm)

	2014	2013
Net cash generated by operating activities	6,979	7,813
Net cash (used in)/generated by investing activities	(3,680)	(3,060)
Net cash used in/(generated by) financing activities	(3,169)	(3,874)
Net increase/(decrease) in cash and cash equivalents	130	879
Cash and cash equivalents at beginning of the period	2,826	1,947
Cash and cash equivalents at end of the period	2,956	2,826

Financial ratios

Profitability

	2014	2013
EBIT (PLNm) operating profit	3,843	3,149
EBITDA (PLNm) operating profit + depreciation/amortisation	6,345	5,612
ROE net profit* to equity at end of the period**	9.4%	6.7%
NET MARGIN net profit* to revenue	8.2%	6.0%
ROA net profit* to assets at end of the period	5.8%	4.0%

* Net profit attributable to owners of the parent.
* Equity attributable to owners of the parent.

Liquidity

	Dec 31 2014	Dec 31 2013
CURRENT RATIO current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.2	1.6
QUICK RATIO current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.6	1.1

Debt

	Dec 31 2014	Dec 31 2013
DEBT RATIO total liabilities to total equity and liabilities	38.3%	41.2%
DEBT/EQUITY RATIO total liabilities to equity*	62.2%	70.1%

* Equity attributable to owners of the parent.

1.2. Financial standing

The PGNiG Group's revenue in 2014 was PLN 34,304m, up by PLN 2,260m (7%) year on year. Despite higher operating expenses, up by PLN 1,566m (5%), the PGNiG Group was able to deliver a consolidated operating profit of PLN 3,843m for 2014, up by PLN 694m on 2013. The Group's EBITDA was up by PLN 733m, to PLN 6,345m.

Exploration and Production

Operating profit of the Exploration and Production segment was PLN 2,006m, down PLN 325m (14%) on 2013. At PLN 3,143m, EBITDA was lower than the year before – by PLN 238m (7%). The segment's revenue was down by PLN 114m (2%) year on year, despite a nearly 6% growth in oil sales volumes. The revenue decline reflected a slump in crude oil prices (the average annual price of Brent in PLN was 10% lower in 2014 than in the previous year). A PLN 211m (5%) increase in operating expenses was a consequence of impairment losses recognised on exploration and production assets. The impairment losses were recognised as a result of a change in the calculation of future cash flows (for impairment test purposes):

- previously the tariff price of gas was used in the calculations, while now they are based on the market price; the calculation method was revised as a result of changes in the natural gas market, including in particular deregulation of gas prices and introduction of the statutory requirement to sell gas on the exchange market,
- the expected new tax expenses in connection with hydrocarbon production were taken into account.

The segment's operating profit was constrained by impairment losses on assets, which as at the end of 2014 amounted to PLN 707m. In addition, based on the analysis of the Group's licences and the effectiveness of its exploration programme, the Group charged PLN 330m of expenditure incurred on dry wells and seismic data acquisition to the segment's expenses at the end of 2014. An increase of PLN 87m (8%) in amortisation and depreciation is related chiefly to the Norwegian assets and follows directly from increased crude oil production.

Trade and Storage

An improvement in efficiency was recorded in the Trade and Storage segment, where operating profit was up PLN 591m year on year, to PLN 583m. The segment's performance in 2014 was driven by the average cost of gas fuel procurement being in a more favourable relation to selling prices than in the previous year, chiefly as a result of lower volumes of gas fuel sold.

Year on year, revenue was up by PLN 3,166m (12%), driven principally by higher revenue from gas traded on the Polish Power Exchange, where PGNiG S.A. sold 3.7 bcm of gas in 2014 (2013: 0.1 bcm). The segment's operating expenses were up by PLN 2,575m (10%) on the back of higher expenses attributable to gas fuel purchased on the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o. Sales made on the Polish Power Exchange by PGNiG S.A. and purchases made on the Polish Power Exchange by PGNiG Obrót Detaliczny Sp. z o.o., which commenced operations on August 1st 2014, are not subject to elimination from the consolidated financial statements.

A decline in gas volumes sold to customers was the key factor affecting the Trade and Storage segment's performance. In 2014, the segment's gas sales volumes, excluding volumes traded on commodity exchanges, was 13.5 bcm, having fallen from 15.1 bcm (11%) in the previous year. The decrease was caused by the average temperatures being higher by 0.9^0C than the year before. In addition, as a result of OOO Gazprom Export's order reductions, imports from countries east of Poland in 2014 were down to 8.1 bcm (by 7%). The segment's improved performance was also associated with lower gas procurement costs, which was a result of the four-quarter nine-month average price of Brent, expressed in PLN, being lower by 2% and lower average annual prices of gas fuel on the TTF (down by 18%) compared with the year before. As at December 31st 2014, the Group held ca. 2.1 bcm of gas in underground storage – approximately 1.4% less than at the end of 2013.

Distribution

The Distribution segment's operating result (EBIT) rose by 54% year on year, to PLN 1,138m, while its EBITDA came in at PLN 2,002m, up by PLN 406m on the year before. The segment's improved operating performance was attributable to a PLN 366m decrease in operating expenses relative to 2013, which was caused by:

- employee benefit expenses being lower by PLN 229m (17%), chiefly as a result of reversing the provision for annual bonuses and lower costs following a change in liabilities under length-of-service awards; costs recognised under this item in 2013 were high due to changes in the pension system and revision of other actuarial assumptions,
- cost of services being lower by PLN 108m (12%), which was chiefly attributable to lower transmission costs due to lower volumes of transmitted gas.

Generation

The Generation segment's revenue was PLN 1,943m, down ca. 6% on the previous year. Operating expenses were down 7%, which, despite lower revenue, translated into a PLN 18m (13%) increase in the segment's operating profit relative to 2013. The revenue decline was attributable to higher average air temperatures (up by 0.9^0C), which resulted in volumes of heat sold being 9% lower than in the year before. The decline in revenue from heat sales was offset by a higher heat tariff (up by ca. 6%), effective as of August 1st 2014. In consequence, revenue from heat sales remained relatively flat year on year. Lower volumes of heat sold translated into lower volumes of cogenerated electricity (down by 6%, i.e. 217 GWh, year on year), which drove down revenue from electricity sales by 13%.

Financial data of the PGNiG Group's segments for 2014 (PLNm)

2014	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	4,346	28,367	280	1,149	162	-	34,304
Inter-segment sales	1,725	458	4,003	794	163	(7,143)	0
Segment's total revenue	6,071	28,825	4,283	1,943	325	(7,143)	34,304
Segment's expenses	(4,065)	(28,242)	(3,145)	(1,781)	(393)	7,165	(30,461)
Operating profit/(loss)	2,006	583	1,138	162	(68)	22	3,843
Net finance costs	-	-	-	-	-	-	(346)
Share in net profit/(loss) of equity-accounted entities	-	129	-	-	-	-	129,0
Profit before tax							3,626
Income tax	-	-	-	-	-	-	(804)
Net profit							2,822

Financial data of the PGNiG Group's segments for 2013 (PLNm)

2013	Exploration and Production	Trade and Storage	Distribution	Generation	Other Activities	Eliminations	Total
Sales to third-party customers	4,580	25,341	165	1,658	300	-	32,044
Inter-segment sales	1,605	318	4,085	405	124	(6537)	-
Segment's total revenue	6,185	25,659	4,250	2,063	424	(6,537)	32,044
Segment's expenses	(3,854)	(25,667)	(3,511)	(1,919)	(489)	6,545	(28,895)
Operating profit/(loss)	2,331	(8)	739	144	(65)	8,0	3,149
Net finance costs	-	-	-	-	-	-	(396)
Share in net profit/loss of equity-accounted entities	-	(44)	-	-	-	-	(44)
Profit before tax							2,709
Income tax	-	-	-	-	-	-	(789)
Net profit							1,920

The PGNiG Group's net result on financing activities improved by PLN 50m (or 13%), thanks mainly to lower interest expense following a reduction in borrowings. In addition, the net result was increased by the PLN 129m gain on remeasurement of shares in SGT Europol Gaz S.A.

As at December 31st 2014, total assets recognised in the consolidated statement of financial position were PLN 48,926m, up PLN 542m (1%) on the end of 2013.

Assets

Property, plant and equipment represents the largest component of the Group's assets. As at the end of 2014, this item amounted to PLN 33,528m, having increased by PLN 495m (or 1%) relative to December 31st 2013, primarily due to a rise in tangible assets under construction unrelated to exploration and evaluation of mineral resources.

Deferred tax assets went down by PLN 450m (or 20%) on realisation of the tax loss in Norway by subsidiary PGNiG Upstream International AS (the tax loss has been accounted for since the launch of gas production from the Skarv field). In addition, a portion of the tax loss carried by the Group was reduced after accounting in 2014 for the acquisition of interests in fields located on the Norwegian Continental Shelf from Total E&P Norge AS.

Noticeable changes were reported in the case of derivative financial instruments, which increased by PLN 260m relative to December 31st 2013 to reach PLN 567, and in the case of current trade receivables, which rose by PLN 150m (4%).

As at December 31st 2014, the Group's cash and cash equivalents stood at PLN 2,958m, up by PLN 131m (5%) relative to the end of 2013.

The value and structure of current assets held by the Group guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 2.2, compared with 1.6 as at the end of December 2013, while the quick ratio rose from 1.1 to 1.6 year on year.

Equity and liabilities

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2013, the Group's equity rose by PLN 1,716m (or 6%), primarily on the back of the net profit for the period of PLN 2,822m, adjusted for the PLN 885m of dividend paid for the previous year.

As at December 31st 2014, non-current liabilities were PLN 12,384m, up PLN 291m on the end of December 2013. The increase is an outcome of higher provisions for production well decommissioning costs.

As at December 31st 2014, the PGNiG Group carried current liabilities of PLN 6,373m, down PLN 1,465m (19%) year on year. This decrease followed mainly from loan repayment and redemption of debt securities, which reduced current liabilities by a total of PLN 1.507m.

Due to a decrease in borrowings used the PGNiG Group, the ratios of equity to liabilities changed. Debt to equity was down from 70.1% as at the end of 2013 to 62.2% as at December 31st 2014. Debt ratio (total liabilities to total equity and liabilities) fell from 41.2% to 38.3%.

Material off-balance-sheet items

As at December 31st 2014, the PGNiG Group's most important off-balance-sheet item was contingent liabilities of PLN 9,520m. The key items of contingent liabilities included:

- a guarantee securing performance of the obligations of PGNiG Finance AB (a subsidiary of PGNiG S.A.) towards bondholders, in connection with the Eurobond programme (PLN 4,067m);
- a bond securing performance of the licence commitments and legal obligations of PGNiG Upstream International AS (a subsidiary of PGNiG S.A.) towards the state of Norway (PLN 2,675m);
- a bond securing performance of the obligations of POGC-Libya B.V. (a subsidiary of PGNiG S.A.) towards National Oil Corporation of Libya (PLN 219m).
- guarantees provided as security in respect of gas supply agreements executed by PGNiG Sales&Trading GmbH, issued within the limits of a EUR 200m (PLN 158m) guarantee line.

Feasibility of investment plans

In 2015, the PGNiG Group intends to maintain a high level of capital expenditure. The spending will focus on:

- Natural gas and crude oil exploration and production, including exploration for unconventional deposits
- Development of storage infrastructure
- Development of distribution infrastructure
- Execution of power and heat generation projects

The PGNiG Group intends to finance investments both with its own funds and debt, e.g. raised through the issuance of notes and bonds, including Eurobonds.

Transactions concluded on non-arm's length terms

In 2013, PGNiG S.A. and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

Explanation of differences between the actual results and forecasts for 2014

The PGNiG Management Board's financial forecast was published in current report No. 24/2014 of February 28th 2014. The results disclosed in the full-year report are not materially different from the forecasts published in the current report (the revenue forecast differs from actual performance for 2014 by +4.9% and the difference in EBITDA is +7.5%; the PGNiG Group's debt ratio did not exceed 2 x EBITDA).

Key equity investments and capital placements at the PGNiG Group

The PGNiG Group's key equity investments in 2014 included:

- Increase of the share capital of PGNiG Obrót Detaliczny Sp. z o.o. by PLN 1,090,000,000 to PLN 1,091,000,000; the additional share capital was provided by PGNiG S.A. in the form of a non-cash contribution
- Acquisition by PGNiG S.A. of short-term notes issued by PGNiG Obrót Detaliczny Sp. z o.o. under the note issuance programme operated within the PGNiG Group; as at December 31st 2014, the value of notes acquired under the programme was PLN 1bn
- Issue of short-term notes offered to PGNiG Group companies; as at December 31st 2014, PGNiG S.A.'s outstanding debt under the notes was PLN 475m
- Disbursement of a new tranche (NOK 850m) of the loan advanced by PGNiG S.A. to PGNiG Upstream International AS; the loan was granted to finance capital expenditure related to the Norwegian Continental Shelf project
- Disbursement of a PLN 400m loan advanced by PGNiG S.A. to PGNiG Obrót Detaliczny Sp. z o.o.; the revolving loan agreement was executed to provide financing for the company's day-to-day operations (mainly settlements related to purchase of gas) until July 25th 2016; as at December 31st 2014, the amount outstanding under the loan was PLN 0.

2. Financial management

In 2014, the PGNiG Group added another external financing option by launching a new domestic note programme. In 2014, the Group was able to issue notes under the following programmes:

- the note programme of June 10th 2010 (as amended by annexes of 2011 and 2014),
- the note programme of May 22nd 2012,

- the note programme of October 2nd 2014,
- the note programme of July 4th 2012, with notes issued by PGNiG TERMIKA S.A.,
- the Eurobond programme of August 25th 2011, with bonds issued by PGNiG Finance AB,
- the note programme of December 1st 2010 (as amended by annexes of 2011 and 2014), addressed to PGNiG Group companies.

On August 8th 2014, an annex was signed to the note programme agreement of June 10th 2010 (as amended by two annexes of 2011). Under the new annex, the agreement with Nordea Bank Polska S.A. was terminated and the note programme agreement was extended from July 31st 2015 to July 31st 2020, i.e. until the final redemption date. Under the programme, PGNiG S.A. may issue discount notes and coupon-bearing notes with maturities ranging from one month to one year, for up to PLN 7bn. The total nominal value of notes issued in 2014 was PLN 1.9bn. As at December 31st 2014, no outstanding debt was recognised by PGNiG S.A. under the programme.

Under the note programme of May 22nd 2012, PGNiG S.A. may issue (for private placement) fixed or floating rate notes with maturities of up to 10 years, for up to PLN 4.5bn. In 2014, the Company did not issue any notes under the programme. As at December 31st 2014, the debt outstanding under notes issued in previous years amounted to PLN 2.5bn.

On October 2nd 2014, PGNiG S.A. signed an agreement with Bank Gospodarstwa Krajowego on a note programme for up to PLN 1bn. Under the programme, expiring on September 30th 2024, the Company may issue discount notes with maturities ranging from one year to four years. In accordance with the agreement, the issue proceeds may only be used to finance investing activities related to, among other things, maintenance of production capacity, diversification of gas supply sources, oil and gas exploration, development of the power sector and ongoing projects involving the construction of underground gas storage infrastructure. In 2014, PGNiG S.A. did not issue any notes under the programme.

In 2014, PGNiG TERMIKA S.A. placed new issues of short-term notes under its programme of July 4th 2012. On December 15th 2014, two annexes were signed to amend the terms of the programme, which extended its term until December 29th 2019, with an option of its further extension by two years, i.e. until December 29th 2021. As part of the programme, PGNiG TERMIKA S.A. may issue (in private placements) discount and coupon-bearing notes for up to PLN 1.5bn, with maturities ranging from one month to one year and interest rates based on WIBOR+margin. In 2014, the company placed 9 issues of notes with a nominal value of PLN 380m. As at December 31st 2014, the nominal value of the notes was PLN 190m. Proceeds from the issues allow the company to finance investment projects, including the construction of a CCGT unit at the Żerań CHP plant, as well as its day-to-day operations.

Under its five-year Eurobond programme established on August 25th 2011, PGNiG Finance AB may issue Eurobonds for up to EUR 1.2bn. In 2014, the company did not issue any Eurobonds. As at December 31st 2014, PGNiG Finance AB's nominal debt outstanding under the issue of 2012 was EUR 500m.

The PGNiG Group used proceeds from the issues of notes and bonds to finance its capital expenditure projects involving exploration for conventional and unconventional oil and gas deposits, field development, construction and extension of underground gas storage facilities and the distribution network, including new connections. The issue proceeds were also used to finance power projects and the Group's operating activities.

Furthermore, pursuant to the agreement of December 1st 2010 (as amended by annexes of 2011 and 2014), in 2014 the Company continued to issue short-term discount notes to PGNiG Group companies. Under an annex of May 6th 2014, the agreement term was extended until May 6th 2019 and the maximum amount of notes was increased from PLN 1bn to PLN 3bn. For PGNiG S.A., the maximum amount of notes in issue remained at PLN 1bn, with the balance allocated to other Group companies.

The note programme is designed to enable the flow of cash from the companies with excess liquidity, thus optimising the liquidity management within the Group. In 2014, PGNiG S.A. and PGNiG Obrót Detaliczny Sp. z o.o. issued notes with total nominal values of PLN 3.3bn and PLN 1.0bn, respectively. As at December 31st 2014, PGNiG S.A.’s and PGNiG Obrót Detaliczny Sp. z o.o.’s outstanding debt under the notes in issue was PLN 475m and PLN 1.0bn, respectively.

Assessment of financial resources management

The funds available to the PGNiG Group ensure that it is able to timely finance all current and planned expenditure related to its principal business and investing activities. Its liquidity is under no threat. The Group has adopted an efficient model under which PGNiG S.A. financially supports its subsidiaries in the execution of investment projects. The liquidity risk is mitigated by bond/note issue programmes under agreements with banks executed in 2014 and in previous years. PGNiG S.A. also has a liquidity reserve in the form of overdraft facilities (PLN 370m in total), which serve to smooth out daily liquidity fluctuations.

Further, to improve the effectiveness of liquidity management at the PGNiG Group, in 2014 a cash pooling agreement was signed with Bank Pekao S.A. The cash pooling arrangement will facilitate liquidity planning within the Group and reduce dependency on borrowed funds. Such more efficient use of free cash will also reduce the Group’s borrowing costs.

On September 30th 2014, Moody’s Investors Service downgraded the credit rating of PGNiG S.A. from Baa2 to Baa3 with a stable outlook. According to Moody’s, the downgrade mainly reflected the Company’s changing risk profile in light of the increasing role of its exploration and production business, as well as challenges stemming from the evolution of the Polish gas market given the Company’s take-or-pay contracts. The agency noted that the rating outlook was stable, supported by the Company’s sound financial and liquidity position. Concurrently, the agency downgraded the provisional rating of the medium-term bond programme of PGNiG Finance AB from Baa2 to Baa3.

2.1. Short-term investments

The financial investments made by the PGNiG Group in 2014 were short-term, with maturities of up to three months. The PGNiG Group companies invested in intra-Group notes, as well as the State Treasury’s debt securities and deposits with investment grade commercial banks. Such placements were consistent with PGNiG S.A.’s financial investment policy adopted by the Company’s governing bodies, and with the Prospectus.

2.2. Borrowings

Credit facility agreements executed in 2014

In 2014, the PGNiG Group entered into credit facility agreements for a total amount of PLN 743m, EUR 35m and USD 8m mainly in order to provide short-term financing of its day-to-day operations. The credit facility agreements executed in 2014 were mostly annexes extending the terms of agreements signed in previous years by one year or several months.

The table below presents detailed information on key credit facility agreements executed by the PGNiG Group in 2014.

Key credit facility agreements executed by the PGNiG Group

Bank	Facility amount (m)	Currency	Interest rate	Type	Maturity date
Bank Pekao S.A.	200	PLN	1M WIBOR + 0.00%	working capital facility	July 16th 2017
Deutsche Bank AG Munich	35	EUR	1M EONIA + 0.85%	working capital facility	December 31st 2017
Bank Pekao S.A.	120	PLN	1M WIBOR + 1.00%	working capital facility	April 24th 2015
HSBC Bank Polska S.A.	60	PLN	1M WIBOR + 0.50%	working capital facility	June 15th 2015
Bank Zachodni WBK S.A.	50	PLN	1M WIBOR + 2.00%	working capital facility	December 31st 2015
Societe Generale S.A. Polish Branch	40	PLN	1M WIBOR + 0.30%	working capital facility	August 31st 2015
mBank S.A.	40	PLN	1M WIBOR + 0.30%	working capital facility	September 4th 2015
ING Bank Śląski S.A.	40	PLN	1M WIBOR + 0.40%	working capital facility	December 4th 2015
Bank Handlowy w Warszawie S.A.	40	PLN	1M WIBOR + 0.30%	working capital facility	December 31st 2015
HSBC Bank Polska S.A.	40	PLN	3M WIBOR + 0.45%	working capital facility	July 9th 2015

Credit facility agreements terminated in 2014

In 2014, the PGNiG Group terminated one overdraft facility agreement executed by Geovita S.A. with mBank S.A. under an annex of April 15th 2013 providing for a facility of PLN 1m maturing on April 18th 2014 and bearing interest at WIBOR O/N + 0.5%. The reason for terminating the agreement was a change of its terms by the bank (under an annex of April 14th 2014), involving monthly reduction of the facility limit until repaid in full by April 16th 2015. The facility at mBank S.A. was repaid in full on September 5th 2014.

In 2014, the PGNiG Group did not advance, contract or terminate any loans.

2.3. Guarantees and sureties

The amount of guarantees and sureties provided by the PGNiG Group in 2014 was PLN 288m. This amount included mainly:

- surety for a loan contracted by PGNiG Sales&Trading GmBH of PLN 149m,
- surety under a guarantee limit agreement provided to PGNiG S.A.'s related entity – Elektrociepłownia Stalowa Wola S.A., of PLN 63m,
- performance bond provided as security for gas supplies by PGNiG Sales&Trading GmBH, totalling PLN 51m.

The amount of guarantees and sureties received by the PGNiG Group in 2014 was PLN 46m. The amount included 71 guarantees (including 57 guarantees of less than PLN 1m), including bid bonds, insurance guarantees and performance bonds.

2.4. Financial risk management

The main objective of the PGNiG Group's financial risk management policy is to limit the volatility of cash flows related to the Company's operations to levels which are acceptable in the short- and mid-term perspective and to build the company value in the long term. In the regular course of business in 2014, the PGNiG Group was exposed to a number of financial risks, and in particular to market risk (including commodity price, interest rate and currency risks) as well as liquidity and credit risks.

Market risk

The PGNiG Group manages market risk through identification, measurement, monitoring and mitigation of key sources of risk, i.e. the adverse effect of changes in commodity prices, exchange rates and interest rates on the Group's financial performance.

The key risks to which the Group is exposed include the risk of commodity price and exchange rate fluctuations, which affect the Group's gas purchases. The Company also executed transactions related to electricity prices, property rights and carbon emission allowances.

In 2014, the PGNiG Group used the following financial instruments to manage the gas price risk:
- Purchase of Asian commodity call options settled as European options
- Commodity option structures (consisting in a combination of two commodity options)
- Commodity swaps.

In 2014, to mitigate the currency risk the Group used the following financial instruments:
- Forward contracts
- Forward contracts settled based on the difference to the average price in a period
- FX swaps
- Purchase of European currency call options
- Purchase of Asian currency call options

PGNiG S.A. also used *CCIRS* transactions (to mitigate the FX and interest rate risks) to hedge the Eurobonds in issue and the loan advanced to PGNiG Upstream International AS, as well as *IRS* transactions to hedge against changes in the fair value of the loan advanced to PGNiG TERMIKA S.A.

PGNiG S.A. used cash flow hedge accounting with respect to transactions hedging payments for gas and transactions hedging gas prices, as well as and fair-value hedge accounting with respect to selected loans bearing interest at fixed rates. The application of cash flow hedge accounting allows the Company to charge the effective portion of the hedge to revaluation capital reserve, which results in the matching of the effect of valuation of hedging instruments on profit or loss and the result on the hedged item. This approach allows to eliminate profit or loss volatility attributable to valuation of derivative instruments and makes it possible to offset its effect in the income statement in the same reporting period. In consequence, the economic and accounting effects of the hedge are reflected in the same period.

Credit risk

The PGNiG Group's credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Group. In 2014, the Group managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (bank deposits and treasury bonds), entering into framework agreements with its trading partners (precisely defining the rights and obligations of the parties), and diversifying the group of its trading partners. The PGNiG Group also worked with leading commercial banks. The key criteria for the selection of counterparties to whom it entrusted a portion of its assets included their financial standing as confirmed by rating agencies, and their respective market shares.

Risk of cash-flow disruptions

Measures taken by the PGNiG Group to mitigate the risk of disruptions in its day-to-day operating cash flows included diversification of electronic banking systems used, ongoing monitoring of credit/debit transactions in bank accounts, collecting information on cash flows within the Group, consolidating bank accounts and entering into overdraft facility agreements. PGNiG S.A. mitigated cash flow volatility related to payments under gas purchase contracts by entering into FX risk hedges (European and Asian currency call options, FX swaps, average rate forwards) and gas price hedges (Asian commodity call options, option strategies, commodity swaps).

Liquidity risk

In order to mitigate liquidity risk, PGNiG S.A. has a liquidity reserve in the form of overdraft facilities (for a total amount of PLN 370m). PGNiG S.A. also prepared cash flow projections for the Company and the Group, estimated the condition and value of assets available for sale, maintained highly liquid financial assets and maintained communication with rating agencies.

3. Projected future financial standing

The PGNiG Group’s financial forecast for 2015 assumes EBITDA at ca. PLN 5.8bn. The forecast is based on the assumption that production of crude oil with other fractions will be approximately 1.27 million tonnes, production of natural gas (measured as high-methane gas equivalent) – approximately 4.5 bcm, the volume of gas sold will reach 22.8 bcm, and that the Group’s capital expenditure will amount to ca. PLN 4.3bn. The PGNiG Group’s performance will depend on oil, natural gas and petroleum product prices, the situation on currency markets, the price of natural gas on the regulated market and commodity exchanges, as well as deregulation of the Polish gas market.

If oil prices remain low in subsequent periods, following a price slump in 2014, this will have an adverse effect on the PGNiG Group’s performance in the Exploration and Production segment. However, if oil prices pick up, driven by reduced US production and unchanged supply from OPEC (Organization of the Petroleum Exporting Countries), the Exploration and Production segment’s operating performance should improve. Conversely, in the case of the Trade and Storage segment − given that oil prices affect the price of gas imported by the Company − the prevailing low oil prices may have a positive effect on the cost of gas and thus the Group’s performance in this segment.

Moreover, the PGNiG Group’s performance will be strongly affected by conditions prevailing on the currency markets. Potential appreciation of the złoty against other currencies (mainly the US dollar) should improve the Group’s performance by reducing the cost of gas imports. However, the short-term situation on the Polish currency market will be strongly affected by a range of factors, including development of the Ukrainian conflict, decisions of the European Central Bank and other central banks of European countries, as well as the position of the Polish Monetary Policy Council. As the Group’s performance is correlated with the exchange rates between the złoty and other currencies, the Group companies will apply a hedging policy to optimise the impact of foreign exchange risk.

In the near future, the Group’s operations will be significantly affected by the position of the President of the Energy Regulatory Office on gas fuel sale and distribution tariffs and on heat sale tariffs. The ongoing deregulation of gas trading in Poland will gradually limit the influence of the Energy Regulatory Office on gas prices for customers. In 2015, gas volumes sold through the Polish Power Exchange are expected to reach approximately 60% of total gas sales. Also, an expected increase in the number of entities offering natural gas and potential diversification of supply sources by PGNiG S.A.’s major customers may intensify competition on the gas market and drive gas prices down in the long term. The downward pressure on gas prices may adversely affect the Group’s performance.

As a possible consequence of the gas market deregulation, PGNiG S.A. may be forced to export its gas surplus. The resulting risk is that a margin on gas exports may be unsatisfactory given the cost of gas procurement under long-term contracts. This is why it was so important for PGNiG S.A. to execute a supplementary agreement to the contract for sale of liquefied natural gas (LNG) with Qatar Liquefied Gas Company Limited (3) in December 2014. Under the supplementary agreement, Qatar's company may sell its entire annual LNG volume on foreign markets, which protects PGNiG S.A. against the risk of having to pay for uncollected LNG under the take-or-pay clause, allowing the Company to minimise the potentially resulting losses in 2015.

The Group's performance will also be considerably affected by regulations governing support programmes for electricity from high-efficiency co-generation and renewable sources. Legislative changes in this area and fluctuations in market prices of certificates of origin (red and green) will have a bearing on the Group's future financial position. Moreover, the PGNiG Group's performance will be affected by legislative changes relating to the Energy Efficiency Act. Such changes will affect the Group's costs related to the requirement to obtain energy efficiency certificates (white certificates) and surrender them for redemption, or pay a buy-out price.

A factor particularly important for the PGNiG Group's development will be its possible acquisition of production assets located outside Poland. The acquisition of fields on the Norwegian Continental Shelf by PGNiG Upstream International AS in 2014 will contribute to higher oil and gas production, supporting the Group's performance in the years to come.

In 2015, the PGNiG Group intends to maintain a high level of capital expenditure. The Group intends to spend the largest amount (PLN 1.9bn) on drilling, well completion and development of fields, including the Gina Krog field on the Norwegian Continental Shelf acquired in 2014, and on extension and upgrade of production facilities in Poland. The Group also plans to implement projects involving extension and upgrade of the distribution network and connection of new customers (PLN 1.3bn). In the Trade and Storage segment, capital expenditure will be incurred on extension of underground gas storage facilities (mainly the cavern facilities in Mogilno and Kosakowo). PGNiG expects that by the end of 2015 the total capacity of all its storage facilities will reach 3.16 bcm. Also, the PGNiG Group intends to incur capital expenditure on growth-oriented and upgrade projects in the Generation segment.

Members of the Management Board

President of the Management Board	Mariusz Zawisza	....
Vice-President of the Management Board	Jarosław Bauc	....
Vice-President of the Management Board	Zbigniew Skrzypkiewicz	....
Vice-President of the Management Board	Waldemar Wójcik	....